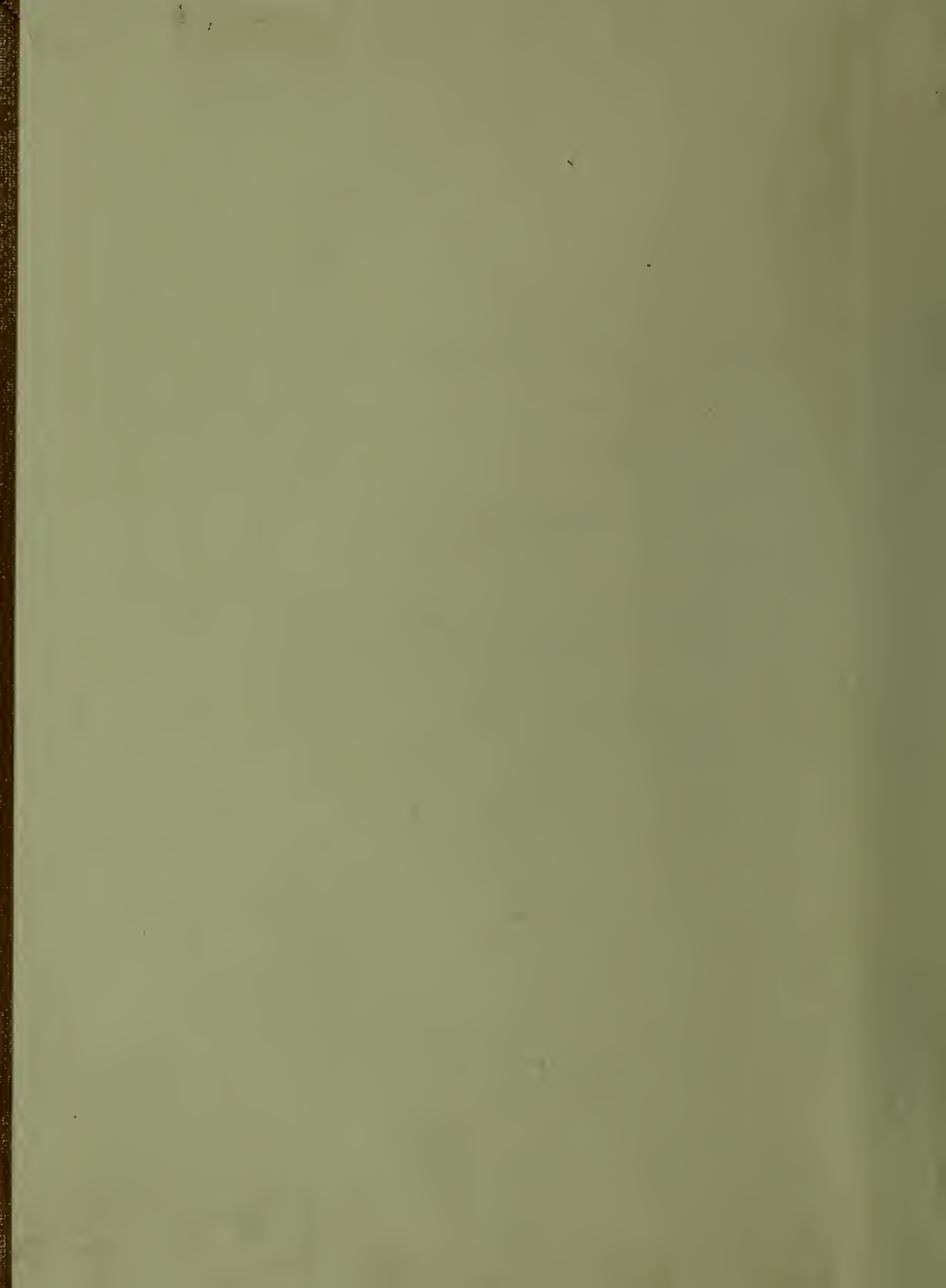


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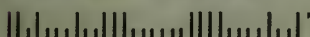
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BY MICHAEL ARNDT (P.74)

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ZAP THERAPY

As neurostimulation approaches an historic transition, medical outfits are placing their bets



Cover Story

74 Rewiring Your Body

First came pacemakers. Now exotic implants are bringing new hope to victims of depression, epilepsy, paralysis, and other diseases. Researchers and doctors are finding that rapid-fire bursts of low-voltage electricity can alleviate symptoms in an astonishing number of illnesses in many parts of the human body. And if early-stage experiments pan out, Alzheimer's could be next

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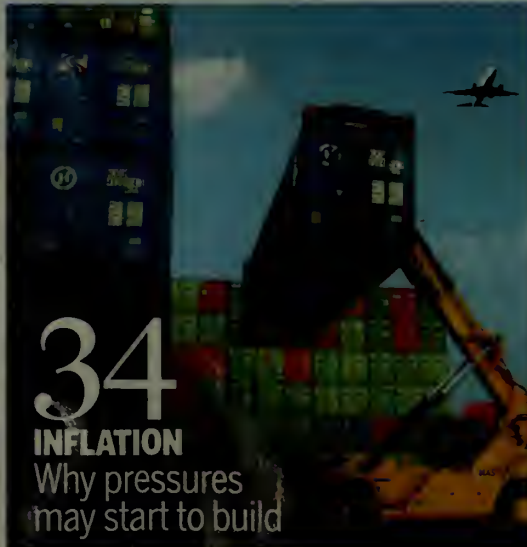
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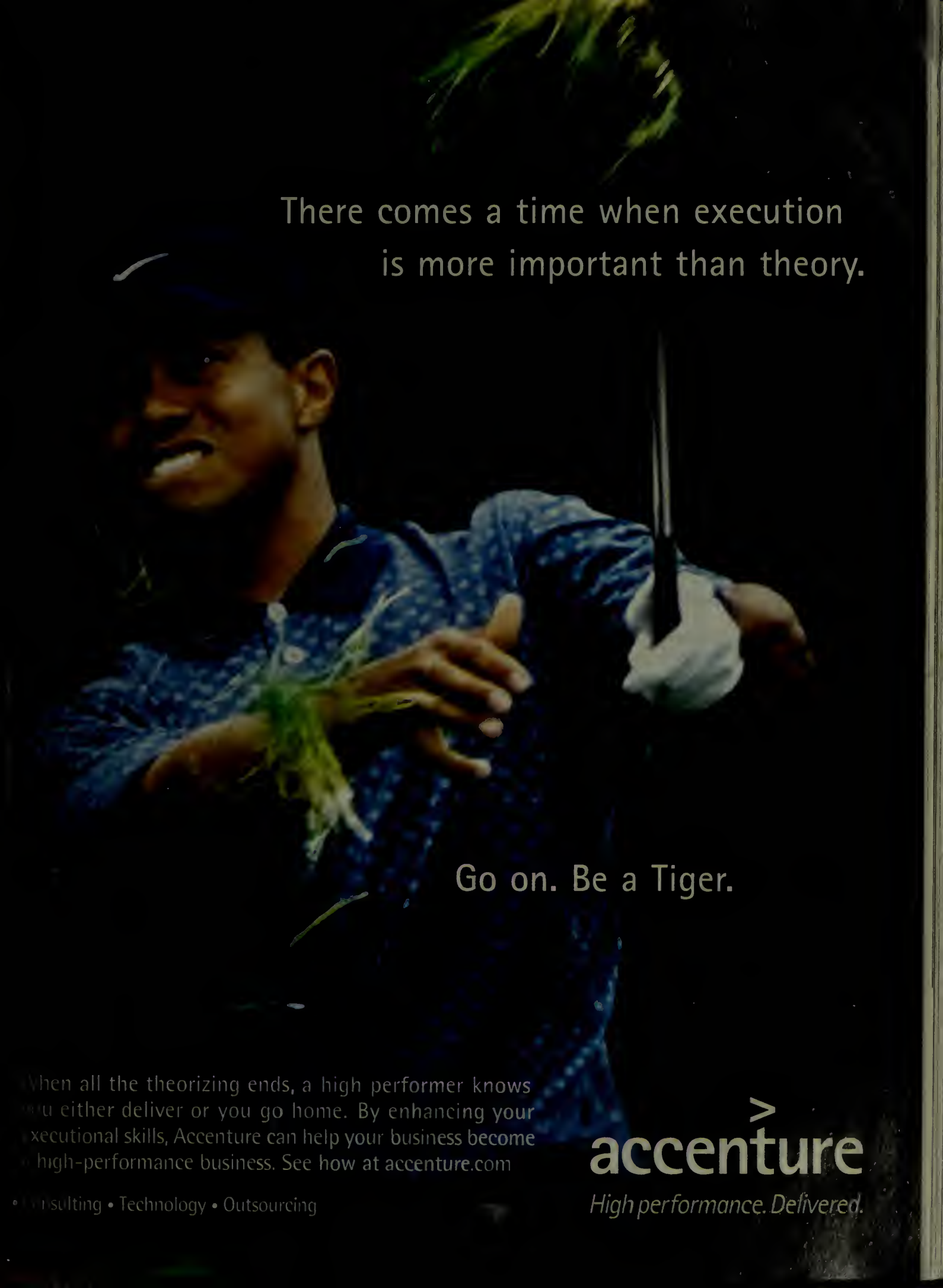
High-performance customer service, delivered.

To maintain its position as one of the country's largest property and casualty insurers—while also positioning itself to offer a broader range of financial products—Allstate wanted to offer new ways of interacting with customers, and to do it on an aggressive schedule. Building on a long relationship with Allstate, Accenture deployed eight development teams to help design and implement The Good Hands Network, which adds integrated Internet and call center channels to the existing system of local agents. Deployed in just 18 months, the two new channels enable customers to do business with Allstate 24/7. Already, over 40 percent of the company's more than 6 million yearly inquiries are made outside of traditional business hours, further extending the company's standing as a high-performance business.

Thomas Cook

High-performance operations, delivered.

A 163-year-old brand with many owners over the years, Thomas Cook UK & Ireland was a respected but complex, decentralized travel services business in need of a return to profitability. In an innovative co-sourcing arrangement with Accenture, the company created a shared services center to consolidate its widely dispersed IT, finance and HR administration operations. Responsibility for strategy and policy was retained by Thomas Cook, with Accenture facilitating operations management. In 16 months, the company removed £140 million in operational costs, helping to achieve an £83 million turnaround, establishing Thomas Cook as a high-performance player in the competitive UK travel business.



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When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

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Tanqueray No. Ten Smoothest
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Juniper Green Organic Best
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Letter to Carly Fiorina: Cook up a Comeback

This may seem harsh, but you blew it. Still, you're not the first CEO to get fired. So fess up to your failures at HP, hire a spin doctor, and network your way back into a corner office



The Delights of Dividend Stocks

Now may be a great time to add some to your portfolio: They're doing well in the current market, fall more slowly if things turn bearish, get favorable tax treatment, and some even beat money-market returns. What's not to like?

Now Open: Steve Wildstrom's Help Desk

Send your tech questions to BW's Technology & You columnist at techandyou@businessweek.com. Help Desk, Steve's new online-only feature, will appear regularly on the Technology channel. Fire away!



Keeping Tight Lips on Taiwan

The island may want and deserve independence, but who—let alone all the U.S.—can afford to vex the powerhouse that is mainland China? For now, the Bush Administration is content to save freedom of speech and democracy for Iraq

A Talk with Sumner Redstone, Video-Game Whiz

The Viacom honcho, who has a big piece of Midway Games, explains why gaming is the new competitor for Hollywood and the networks



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Gilles Bouchard, CIO
and EVP of Global Operations
Hewlett-Packard Company



access

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"The debate is too much on the risks, without putting them in balance with the benefits."

—Sidney Taurel, chairman and CEO of Eli Lilly, on the drug safety issue

WORLD BY IRA SAGER

AFTER 9/11 VISAS: ENOUGH WITH THE HARDBALL

WHILE SAM HAS quietly eased security restrictions that had crimped the flow of foreign workers and overseas students into the country. On Feb. 11, the State Dept. extended the duration of visa security clearances for students and persons working in sensitive technical fields such as nuclear engineering. Now, security clearances for students could last for years, up from the previous one-year limit. The clearance for temporary workers has been extended to a maximum of two years. Leaders in the education

and business communities have been urging the government to ease the restrictions, which they say contribute to a decline in top-notch talent. In 2003, the number of student visas issued by the U.S. slid 8%, to 215,694, after falling 20% in 2002. Foreigners make up about half of U.S. graduate science and engineering students. Last year, the number of workers

with advanced degrees or skills admitted to the U.S. plunged 65%.

"It will help fight this perception that it's hopeless and hard to get a visa," says Peggy

Blumenthal, vice-president of the **Institute of International Education**, a student-exchange advocacy group. It seems the U.S. is putting the welcome mat out again.

—Spencer E. Ante



THE HILBERTS
In happier days

WRETCHED EXCESS

Is That a Genuine Mellencamp?

STEPHEN HILBERT, the founder and former head of insurance conglomerate **Conseco**, has always had a taste for the high life: Thoroughbred racehorses, vintage cars, fine wines. Now the public will have a chance to own a slice of that life. During two days starting on Feb. 25, some prized Hilbert possessions will be auctioned off on the grounds of Le Château Renaissance—his \$25 million, 35-acre former spread in Carmel, Ind.

Items include a 1956 red Ford T-bird, once owned by Madonna; numerous Napoleonic items, including his letters; and some 600 bottles of vintage wines. The public will also find handmade cufflinks and paintings, including two by Edouard Cortès and one by local rock star John Cougar Mellencamp.

How did it come to this? In October, an Indiana court ruled that Hilbert owed the company \$72 million in interest on unpaid stock loans. Hilbert has appealed the judgment, which has been stayed. If he wins, the auction proceeds will be his. Conseco also won a court order allowing it to foreclose on the house. Hilbert and his wife, Tomisue, a former exotic dancer, agreed to move rather than be forced out. Conseco declined to comment, and Hilbert did not return calls.

—Marcia Vickers

THE BIG PICTURE

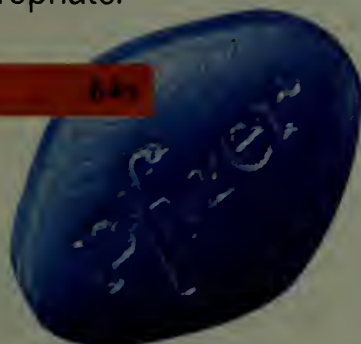
ADVERTISING DYSFUNCTION Are the current ads for erectile dysfunction drugs Viagra, Cialis, and Levitra appropriate?

APPROPRIATE

NO PROBLEM

NOT SURE

3.2%



A tally of more than 2,400 responses to a BusinessWeek Online question posted from Feb. 17 to Feb. 22



PHILANTHROPY CHARITY BEGINS IN THE BOARDROOM

WANT TO LURE candidates to your board? Make donations in their name. Although only 10% of companies have programs that match their



directors' charitable gifts, says consultant Towers Perrin, those who do are an influential bunch, including **Altria**, **General Electric**, **IBM**, and **McDonald's**.

COLUMBIA GE is bringing good things

Gift-matching provides a powerful noncash incentive for candidates involved in philanthropy—and for whom a salary is often just a tax burden. GE matches directors one-to-one up to \$100,000 and donates \$1 million to the charity of a retiree's choice—as it did to **Columbia University** in 2002 on behalf of Gertrude Michelson.

Unlike practices at scandal-racked outfits such as **Fannie Mae**, **Tyco**, and **Enron**, which raised conflict-of-interest questions for giving heavily to directors' favored charities, these matches usually have a cap of \$100,000 a year. Small enough for critics and a nice perk for both directors and nonprofits. —*Jessi Hempel*

MAD AVE

CAMEO And the 2004 Award for Overall Product Placement goes to... Pepsi. Online magazine Brandchannel.com, produced by Interbrand, has released its own version of the Oscars for brands that had starring roles in 2004 films. **Pepsi earns top honors for scenes in seven movies that topped the box office for at least week.** The award for most press coverage: Audi. Its concept car had nearly nine minutes of screen time in sci-fi thriller *I, Robot*, drawing media attention in 40 countries. Apple grabs the Lifetime Achievement Award for Product Placement with Macs in dozens of films since 1986—from the slasher flick *Seed of Chucky* to the romance *Something's Gotta Give*. —*Jessi Hempel*

REVOLVING DOOR BRISK TURNOVER IN CEOs

HANGING ON TO the corner office is getting harder. CEO turnover at 1,000 large companies jumped from 44 departures in 2002 to 97 in 2004, says a survey by public-relations firm **Burson-Marsteller** and executive trainer **RHR International**.

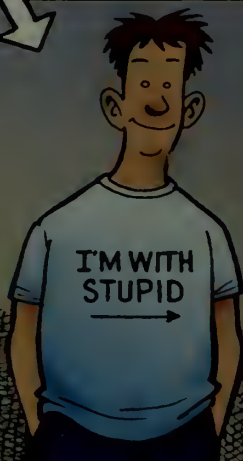
Boards, less tolerant of failure, are giving CEOs an average of 18 months to prove themselves. "Boards are viewing everything with an eagle eye," says Leslie Gaines-Ross, chief research officer at Burson-Marsteller. She predicts that in 2005 directors will cut laggards loose even faster. —*Louis Lavelle*

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FACE TIME

JOE MANSUETO



HIS KIND OF TOWN FOR A MAGAZINE

Piloting mutual-fund researcher Morningstar through an auction-style initial public offering will keep CEO Joe Mansueto busy in coming months. But if he wants to take a break, he can do so with *Time Out Chicago*, a weekly magazine he'll help launch on Mar. 3.

Mansueto, 48, is a 50% partner in the new glossy, sharing ownership with *Time Out New York*. Like the quirky, nine-year-old New York version, *Time Out Chicago* will offer arts and entertainment listings—with lots of cheeky commentary. It's the first step in expanding the U.S. presence of London's Time Out Group; Mansueto says he's interested only in the Chicago edition.

Mansueto, who started Morningstar in 1984 in his one-bedroom Chicago apartment, lost out to Tribune Co. in the bidding for *Chicago Magazine* in 2002. His history in publishing goes back to high school in northwestern Indiana, when he worked as a sports stringer for a local paper. "I'm a magazine junkie," he says. Now he has a solid fix.

—Joseph Weber

HOLLYWOOD

GEFFEN'S EAST COAST CLOSE-UP

DAVID GEFFEN, CEO of DreamWorks SKG, will admit to something that few among Hollywood's glitterati might: When he started out he "really didn't have any big plans." As a boy in Brooklyn, he never dreamed he would someday own an independent music label, help start a movie studio (with Steven Spielberg and Jeffrey Katzenberg), and become one of America's top philanthropists. No, that wasn't in the cards. *BusinessWeek* Editor-in-Chief Stephen B. Shepard spoke with Geffen on Feb. 17 as part of the Captains of Industry series at Manhattan's 92nd Street Y. Some edited excerpts:

If he were just starting out:

I wouldn't go into the entertainment business. It's too expensive to make the product. The chances of hitting a home run are smaller and smaller and smaller. I would go into computers, the Internet business. I would like to be one of the guys who invented Google. That sounds like a good job.

Dealing with piracy:

The film business has been smarter about pricing [to discourage piracy]. The record industry, when the cost of manufacturing went down, raised prices. That was a big mistake. The soundtrack of *Jaws* costs more than the DVD.

The movie business priced DVDs correctly. Every six months, it lowers prices.

Early troubles at DreamWorks

A couple of times we were the verge of bankruptcy. When we made *Sinbad* we lost \$10 million. We just didn't understand how challenging it was to start a company—when you have to put your entire infrastructure in place with product going through it. And the cost of making [and marketing] movies escalated beyond anything we imagined.

Animation vs. live-action film

The animation company has a market cap of over \$4 billion and the whole company has a market cap well over \$5 billion. The animation business is infinitely more profitable.

Walt Disney's problems:

Over the past 10 years, Disney has been a sieve in which incredibly talented people have either been fired or left because of the atmosphere there—beginning with Jeffrey Katzenberg.

How he invests:

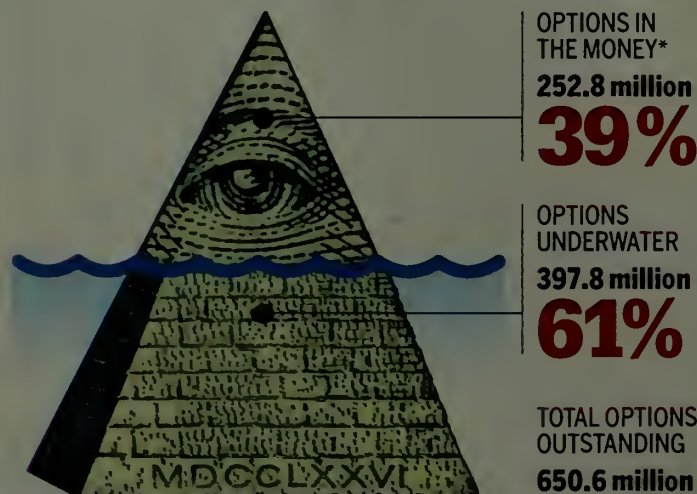
I met Eddie Lampert [who now controls Kmart] when he was 25. In 1991 I gave him \$200 million to invest. He has compounded annually since then at 30% a year. So you can figure that out for yourself.

Hillary Clinton for President 2008:

I hope not. She can't win, and she's an incredibly polarizing figure. I think ambition is a good enough reason.

TAKING STOCK

BIG DEAL? On Feb. 18, Time Warner said that it, like many others, would stop awarding options to most workers because they will have to be expensed. Employees may greet the news with a shrug, since most of their options are underwater:



*assuming that all options with an exercise price of \$20 or less are in the money. Time Warner shares closed at \$17.65 on Feb. 22.

Data: *BusinessWeek*, Bloomberg Financial Markets, Time Warner 10-K, filed Mar. 15, 2004

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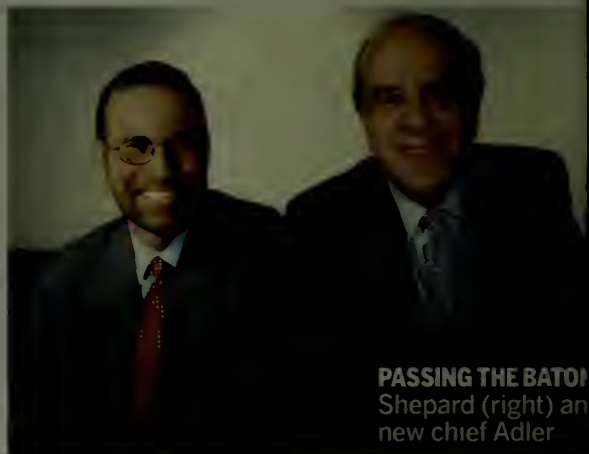
A Fond Farewell

IT'S TIME TO SAY GOOD-BYE. After more than 20 years as editor-in-chief of *BusinessWeek*, this is my final issue. I leave to become founding dean of a new graduate school of journalism at the City University of New York—a wonderful opportunity to build a publicly funded graduate school from the ground up.

It has been a great ride. I've had a front-row seat at some of the major events in business. When I was named editor-in-chief in August, 1984, the Dow Jones industrial average was around 1,200. Today it is well above 10,000. The personal computer was a novelty, the Chinese wore Mao suits, and few people knew much about Bill Gates or Alan Greenspan.

It's tough to leave. I will miss the terrific stories, the weekly rhythm, the wonderful people at *BusinessWeek*, and my many friends throughout The McGraw-Hill Companies. Editing this issue—my 1,044th—has been as much fun as my first. It's still a thrill—and a privilege.

BusinessWeek has had only eight editors in its 75 years. My successor, Stephen J. Adler, is the ninth. Most recently Steve was a deputy managing editor of *The Wall Street Journal* and editorial director of its online edition. Steve will take over next week. But



PASSING THE BATON
Shepard (right) and new chief Adler

the transition has been under way for two months. Steve has the skills and talent to be a great editor-in-chief, building on a grand tradition for a new era. As you will see when you open your magazine in the weeks and months ahead, you are in good hands.

My thanks, dear readers, for your support for so many years.

Stephen B. Shepard

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BusinessWeek

MARCH 7, 2005 (ISSN 0007-7135)

3923

Published weekly, except for one week in January and one in August and an additional issue the first week of April, by The McGraw-Hill Companies, Inc. **FOUNDER:** James H. McGraw (1860-1948).

EXECUTIVE, EDITORIAL, CIRCULATION, AND ADVERTISING OFFICES: The McGraw-Hill Companies Building, 1221 Avenue of the Americas, New York, N.Y. 10020. Telephone: 212-512-2000. Telex: Domestic 127039; Int'l. 2360127039. U.S. subscription rate: 1 year \$59.97; 2 years \$99.97; 3 years \$119.97. Canadian subscription rate: CDN \$94.95 per year; 2 years U.S. \$157.95; 3 years U.S. \$189.95. Mexico Subscription 1 year U.S. \$135.00, Brazil 1 year U.S. \$150.00, all other Latin America countries 1 year U.S. \$170.00; 2 years U.S. \$250.00. Outside of U.S., Canada and Latin America: U.S. \$199.00 per year. Single copies/back issues, \$9.95. Call 1-800-298-9867 or email: busweek@mhmsinc.com. Subscriber Services: 1-800-635-1200. TDD: 1-800-554-1579

POSTMASTER: Send address changes to BusinessWeek, P.O. Box 53235, Denver, CO 80322-3235. Periodicals postage paid at New York, N.Y., and at additional mailing offices. Canada Post Publication Mail Agreement Number 40012. Registered for GST as The McGraw-Hill Companies, Inc. GST #R12307. Copyright 2004 by The McGraw-Hill Companies, Inc. All rights reserved. registered in U.S. Patent Office. European Circulation Center, McGraw House, Maidenhead, Berks, England. Telephone: 01628-23431. Telex: 84.

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Readers Report

CORRECTIONS & CLARIFICATIONS

In "Not your father's ethanol" (Industries, Feb. 14 in some editions), the correct amount of wheat straw from which Iogen Corp. produces 260,000 gallons of ethanol is 3,200 tons.

NANOTECHNOLOGY'S OBSTACLES ARE TREMENDOUS

NANOTECHNOLOGY PROMISES to usher in the next Industrial Revolution and replace our entire manufacturing base with a new, radically precise, less expensive, and more flexible way of making products ("The business of nanotech," Cover Story, Feb. 14). Yet the future of nanotechnology will rely first and foremost on creating the instruments, metrology devices, and tools (e.g., scanning probe microscopes, dip-pen lithography, nuclear magnetic resonance spectroscopy, etc.) that will enable us to effectively position molecules and build complex structures with automatically precise control (through top-down fabrication methods or bottom-up assembly techniques).

Every aspect of basic nanoscale science and the commercial production of nanotechnologies will depend on the capacity of these "picks and shovels" to measure, sense, fabricate, and manipulate matter at the molecular level.

—Noel H. Nevshehir
*Society of Manufacturing Engineers
Dearborn, Mich.*

YOU SUGGEST that carbon nanotubes show potential for hydrogen storage, thus improving the odds that hydrogen fuel cells could replace fossil-fuel engines. The development of sophisticated means for fuel storage of hydrogen does not solve the main problem of the present uneconomic cost of producing hydrogen for the fuel cell. As it stands, the use of the chemical hydrogen for fueling the fuel cell utilizes more energy in its extraction from natural gas than is derived from burning it to power the fuel cell in motor vehicles. That makes fuel-cell-powered cars a form of economic science fiction for the very long-term future, if not forever.

—Michael Zelvin
New York

ONE OF THE largest challenges facing nanotechnology today is the lack of a business model to treat new materials as something other than commodities. Over the past century conventional materials prices have fallen relative to other goods,

thus nanomaterials are often asked to compete with conventionally produced materials at costs that are lower by orders of magnitude. It can be a very different hurdle for a nanomaterials producer to demonstrate that a new quantum material may offer performance gains sufficient to compete with existing products.

—Samuel Brauer
*Nanotech Plus
Stamford, Conn.*

TAXES: DOES WARREN BUFFETT PRACTICE WHAT HE PREACHES?

IN "LEARNING to think like Warren Buffett" (News: Analysis & Commentary, Feb. 14), it is interesting, to put it mildly, that Warren E. Buffett loudly joined the liberal chorus that railed against President George W. Bush's "tax cuts for the rich" while simultaneously avoiding as much as possible of "his fair share" of tax liability as a professional investor.

—Dan Coggin
Charlotte, N.C.

A BRISK TRADE IN IDEAS FOR BOOSTING U.S. EXPORTS

"THE EXPORT engine needs a turbocharge" (News Analysis & Commentary, Feb. 14) asks: "What's the key to increasing exports?" Don't wait for the government to do it. Governments don't increase exports, businesspeople do. They always have. The U.S. market represents only 5% of the world's population. The other 95% may not be as wealthy but still represent a large and faster-growing group of consumers well worth pursuing. Companies in that other 95% of the world are working hard to get a piece of the U.S. market. The key to increasing U.S. exports is having American companies realize that the best way to defend their share of the American market is to go after foreign markets.

—Michael Wynne
*International Management Consulting
Associates
Naperville, Ill.*

A CONCERTED government effort to promote U.S. exports is part of the solution. The Clinton Administration developed some programs in this field, such as organizing tours of senior executives, led by the Treasury or Commerce Secretary, to promising markets and setting up a "war room" in the Commerce Dept. to target major infrastructure opportunities abroad and help U.S. companies win contracts arising from them.

If the Bush Administration has taken any initiatives in this area, they haven't been very visible. Sadly, the Presidential

campaign of Senator John Kerry (Mass.) scarcely addressed this issue. Since the election a lot has been written about the need for the Democratic Party to once again become a "party of ideas." Development of a comprehensive export promotion strategy would be a good place to start.

—James S. Altso
New York

OUR BUSINESS schools typically do not require courses in international business. Therefore, most of our graduates know little about the international aspects of their fields, whether it's accounting, finance, marketing, management, or any other business discipline. If Japanese, Korean, German, or French companies had the goods and services that American companies offer, they would sell hundreds of billions more abroad than we do.

—Christopher M. Koo
*Western Michigan University
Kalamazoo, Mich.*

SOCIAL SECURITY: THE POLS AREN'T LISTENING

YOUR FEB. 14 Readers Report responding to "Social Security: Are private accounts a good idea?" (Special Report, Feb. 24) consisted of seven letters commenting on Social Security reform. All had one thing in common: They presented better ideas than what the Administration is currently proposing. Seven relatively random people from across the country forth simple, effective, wide-ranging ideas. Social Security may need to be fixed, but what we really need is debate and political representatives willing to listen and do the right thing. There are much better solutions out there.

—Donae Eckert
AK

How to reach BusinessWeek

LETTERS FOR READERS REPORT

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A photograph of a farmer standing in a vast field of corn. The farmer is wearing a dark shirt and light-colored pants, and is holding a small object in their hands. The field is filled with rows of corn plants, and the sky is visible in the background.

oolitic, Indiana, an hour shy of sun-up and a farmer is getting to work.

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That's why we work to be essential to him — creating thousands of products
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A Most Victorious Vaccine

SPLENDID SOLUTION Jonas Salk and the Conquest of Polio

By Jeffrey Kluger; Putnam; 373pp; \$25.95

Polio ought to be a disease of the past. This year marks the 50th anniversary of the momentous announcement that Dr. Jonas Salk had created a vaccine that was “safe, effective, and potent”—sparking jubilation around the world. Thanks to that vaccine, there has been no polio epidemic in the U.S. since the late 1950s,

and the World Health Organization (WHO) aims to wipe out the disease by 2008. Nevertheless, WHO reported in February that three people were afflicted with polio in the holy city of Mecca, in Saudi Arabia. Because of the failure by some nations to vaccinate all their children, polio was reported in six countries last year, and the worldwide total of cases rose 50%, to 1,185.

Splendid Solution: Jonas Salk and the Conquest of Polio by Jeffrey Kluger couldn't be more timely. Kluger, a *Time* senior writer and co-author of the book on which the movie *Apollo 13* was based, chronicles the terrible polio epidemics in the first half of the 20th century and the Herculean scientific effort by Salk and his colleagues to create a vaccine quickly.

Kluger nails down the details in this story of a Manhattan Project against polio. He graphically describes the battling scientific camps, the setbacks, and the rising toll of dead and crippled children that lent such urgency to the effort. Less gripping are those swaths of the book that are essentially a biography of Salk, who simply wasn't a colorful character. A second book, due out in April—*Polio: An American Story* by historian David M. Oshinsky—takes a larger view, focusing on the cultural and historic forces behind the vaccine effort. But the unassuming Salk is at the center of both books.

That's as it should be, because this methodical scientist was one of the undisputed heroes of the 20th century. It's hard to imagine today what it was like to confront polio in the prevaccine era. Polio is transmitted by contact with an infected person, and in the years after 1900 it began to reach epidemic proportions. In 1916, the U.S. reported 27,000 cases, 6,000 of them fatal and almost all of them among young children. In 1952, polio struck 57,879.

Kluger movingly describes the panic that gripped the U.S. every summer, the season for polio. Parents kept their children locked inside and scrupulously clean in hopes of thwarting the virus. But it struck without warning, paralyzing its victims within hours—most of them never fully to recover. Adults weren't safe either: In 1921 it crippled 39-year-old Franklin D. Roosevelt. He was determined to spare others,

and 17 years later, after becoming President, Roosevelt created the first private foundation dedicated to eradicating disease, the National Foundation for Infantile Paralysis (NFIP). It quickly became known by the name of its most effective fund-raiser, the March of Dimes.

Salk finished medical school just as the NFIP was getting started. He helped develop the first successful flu vaccine during World War II and in 1947 set up his own lab at the University of Pittsburgh to study polio.

It is at this point in the chronology that *Splendid Solution* becomes truly riveting. Polio research was dominated by camps. One, led by Albert Sabin, believed the most effective approach would be a vaccine containing a weakened but still-living virus. Live virus vaccines had been used for other diseases, and although there was always the potential that the vaccine itself could cause the disease, the approach was well-established. Salk wanted to use a more novel, killed-virus method. Such vaccines can be hard to mass-produce, but Salk felt they were safer.

Salk's method won out primarily because he developed his vaccine first. In 1954, the NFIP undertook the largest clinical trial ever, inoculating 1.8 million schoolchildren. On Apr. 12, 1955, before a huge press conference at the University of

Michigan in Ann Arbor, NFIP scientists reported that the vaccine worked. Salk became a national hero, but the public adulation and his failure to acknowledge publicly the contributions of his lab staff caused the scientific community to turn against him.

It is here that Kluger lets the reader down, giving only a cursory account of the fates

of the key players. Sabin did create a live-virus vaccine, and controversy over the two approaches raged for decades. It was only in 2000 that the U.S. decided the killed-virus vaccine was superior, because the few cases of polio reported during the years that both were in use could be directly traced to the live vaccine.

Kluger's book is well-written, but his hagiographic treatment of Salk diminishes his effort. Still, it is worth delving into the history of this important episode in medicine as a reminder of how difficult the battle can be against virulent diseases—and how worthwhile. ■

—By Catherine A.



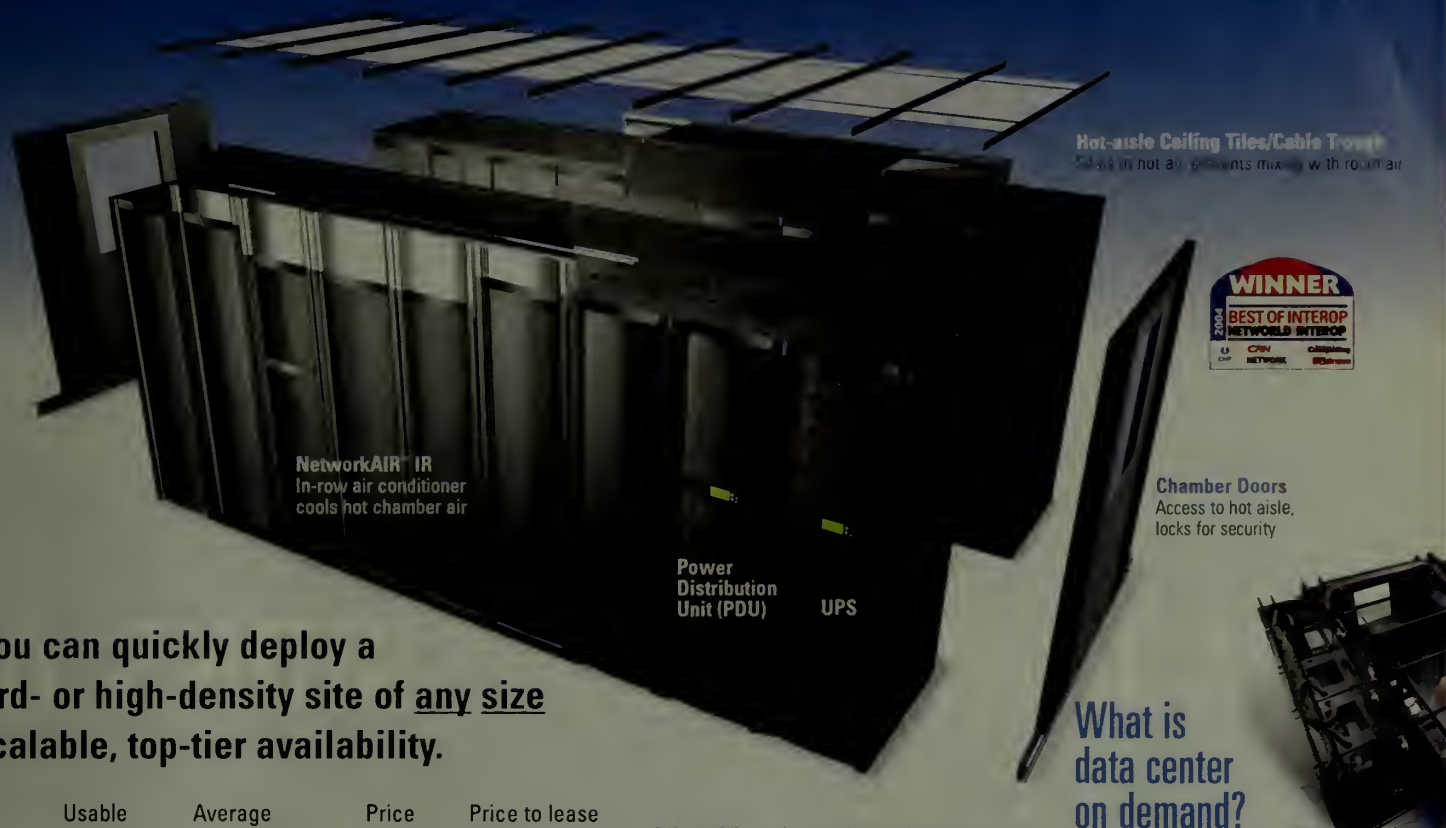
Before Salk's breakthrough, polio struck 57,879 in one year alone

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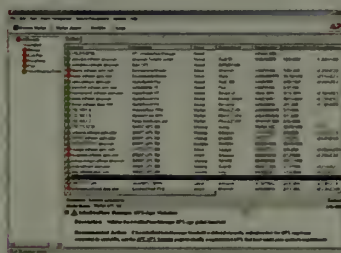
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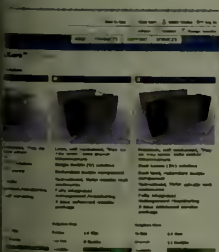
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BY STEPHEN H. WILDSTROM

Beaming Into Your PC From Anywhere

Unless you do all your computer work on a laptop that is always at hand, you have probably found yourself in desperate need of information stored on a PC somewhere that you weren't. Two new services, GoToMyPC and LogMeIn, promise simple and secure access to your computer from just about anywhere—provided, of course, that you leave it on, and online.

Remote control programs such as Laplink and Symantec's PCAnywhere have been around almost as long as PCs. Microsoft's Windows XP Professional even includes a feature called Remote Desktop Access. But all of these require setting up a direct network connection between two computers, and they are easily frustrated by firewalls and other network complexities.

GoToMyPC, from Citrix Online, and LogMeIn, from 3am Labs, make access a lot easier. To use either of these similar products, you start by installing a program on the Windows computer you want to control remotely and registering with the service. When you want to connect to your home or office PC, you log in on a Web page, then select the PC you want to connect to from a list of computers that you have registered. In theory you can do this on any Internet connection, but in practice dial-up will be too slow to give satisfactory results.

AS SOON AS THE SERVER SETS UP a network path between the two computers, you're ready to take control. Your target computer need not have any user logged in, but it must be on and physically connected to the network. The log-in procedures are different for the two services, but each queries you for passwords on three separate occasions. All traffic between computers is encrypted from end to end. Because the services use standard Web communications techniques, they work through most, though not all, corporate firewalls without intervention from information-technology departments. You may, however, run into trouble if you are trying to get into your PC from a public computer, such as those in libraries or hotel business centers. These may not permit you to download the application you need to establish remote connections.

Although the computer being accessed must run Windows, you can use GoToMyPC from any browser that supports Java. That includes Macs and even Pocket PCs, though the latter's displays are too small to be of much use. LogMeIn can be used from Windows computers and Pocket PCs but not Macs.



LogMeIn and GoToMyPC make remote access easier than ever

Once a connection is established, the screen of the remote PC appears in a browse Window, which can be expanded to fill the screen with a single click. Your typing, mouse movements, and clicks act just as though you were working on the remote computer, though with a noticeable lag. (How bad the lag is depends mainly on the speed of your connection.)

There is one fundamental difference between the two services: GoToMyPC costs \$2 a month after a free trial for 3 days or one hour of cumulative use. LogMeIn's basic version is free but lacks some features of GoToMyPC, including file transfer between two computers and the ability to print from the remote computer.

to a printer where you are working. A paid version of LogMeIn, at \$13 a month, adds those services.

GoToMyPC is the more powerful of the two programs. It offers more flexibility in matching screen resolutions, especially if the PC you're working on has a smaller display than the remote one. And its more accurate rendering of the screen enhances the feeling that you are actually working at the remote computer. But free is a good price, and LogMeIn is more than adequate for a lot of users. It also lets you set up multiple computers on a single account, so you can run your home PC from work and your work machine from home. When you need something badly and it's on a computer far away, either of these services can be a lifesaver. ■

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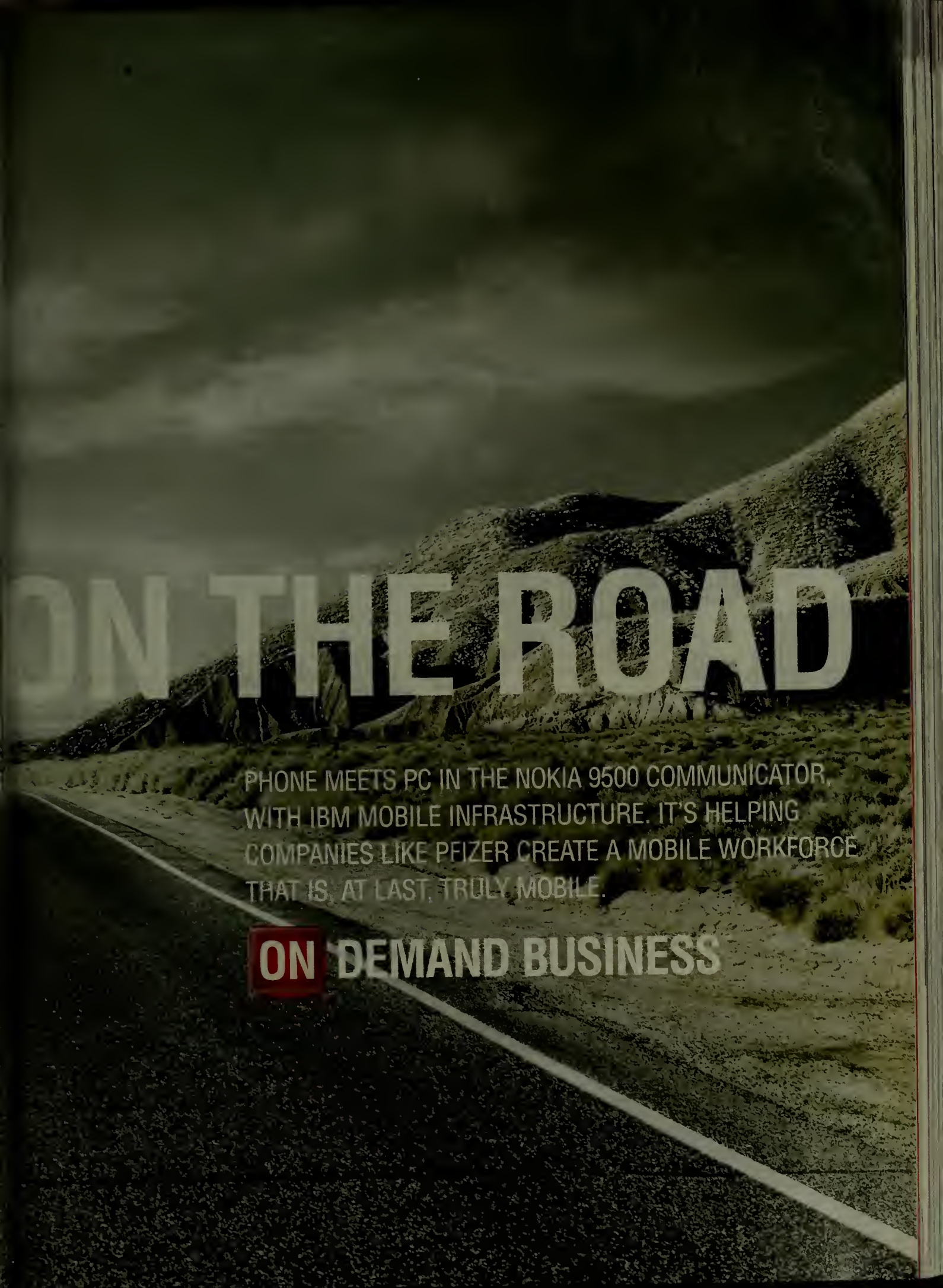


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ON THE ROAD

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ON DEMAND BUSINESS



BY JEFFREY E. GARTEN

Don't Just Throw Money At the World's Poor

In recent weeks government officials around the world have put forth several high-profile proposals for pumping huge amounts of money into aid for the world's poor—the 2.5 billion people who live on less than \$2 a day. I believe global economic development ought to be accorded far more attention than it usually gets, given its importance to economic growth

and the battles against terrorism, disease, and the drug trade. But the focus on dramatic increases in foreign aid could be an overreach and an ill-advised diversion from other critical approaches to alleviating poverty.

On Jan. 17, the U.N. released a report imploring wealthy countries to double their foreign aid. The goal: to halve the number of people living in extreme poverty by 2015. Shortly afterward, Britain proposed a modern-day Marshall Plan for Africa. It also called for a major injection of funds that would come from issuing new government-guaranteed bonds. French President Jacques Chirac, meanwhile, suggested raising aid with new international taxes on such things as financial transactions and aviation fuel. Japan pushed a big recapitalization of the African Development Bank. The Group of Seven asked the International Monetary Fund to sell some of its gold holdings to provide even more assistance. All this occurred even as more than \$5 billion was being mobilized on behalf of the tsunami victims in Asia.

EVEN IF THESE IDEAS CAME TO FRUITION, it's doubtful that these proposals will produce the desired results. The fact is that huge amounts of foreign aid are already in the pipeline. The Organization for Economic Cooperation & Development estimates that its members will have increased their assistance from \$58.3 billion in 2002 to \$88 billion by next year. The research of Todd Moss of the Center for Global Development in Washington shows that for at least 20 African nations, foreign aid constitutes more than half their public expenditures. And let's not forget the large and growing antipoverty programs of organizations such as the Bill & Melinda Gates Foundation.

Moreover, most development experts acknowledge the impediments to effective use of aid brought about by poor governance and corruption in many developing countries. Are the donor nations assuming that these obstacles will be miraculously washed away with enough money? Are they also counting on the disappearance of the notorious lack of coordination by aid-giving agencies that leads to enormous waste?

I'm for more aid, to be sure—if it is wisely used. The

current frenzy seems more like political one-upmanship among governments than sound policy. It could set unrealistic expectations that result in public disillusionment with development efforts.

It also could draw attention away from alternatives, such as strengthening the engines of economic growth in developing countries, including the private sector, and from ideas, such as those of Peruvian economist Hernando de Soto, who advocates giving poor people clear title to the land and housing they already occupy, so that they can use their assets as collateral for credit.

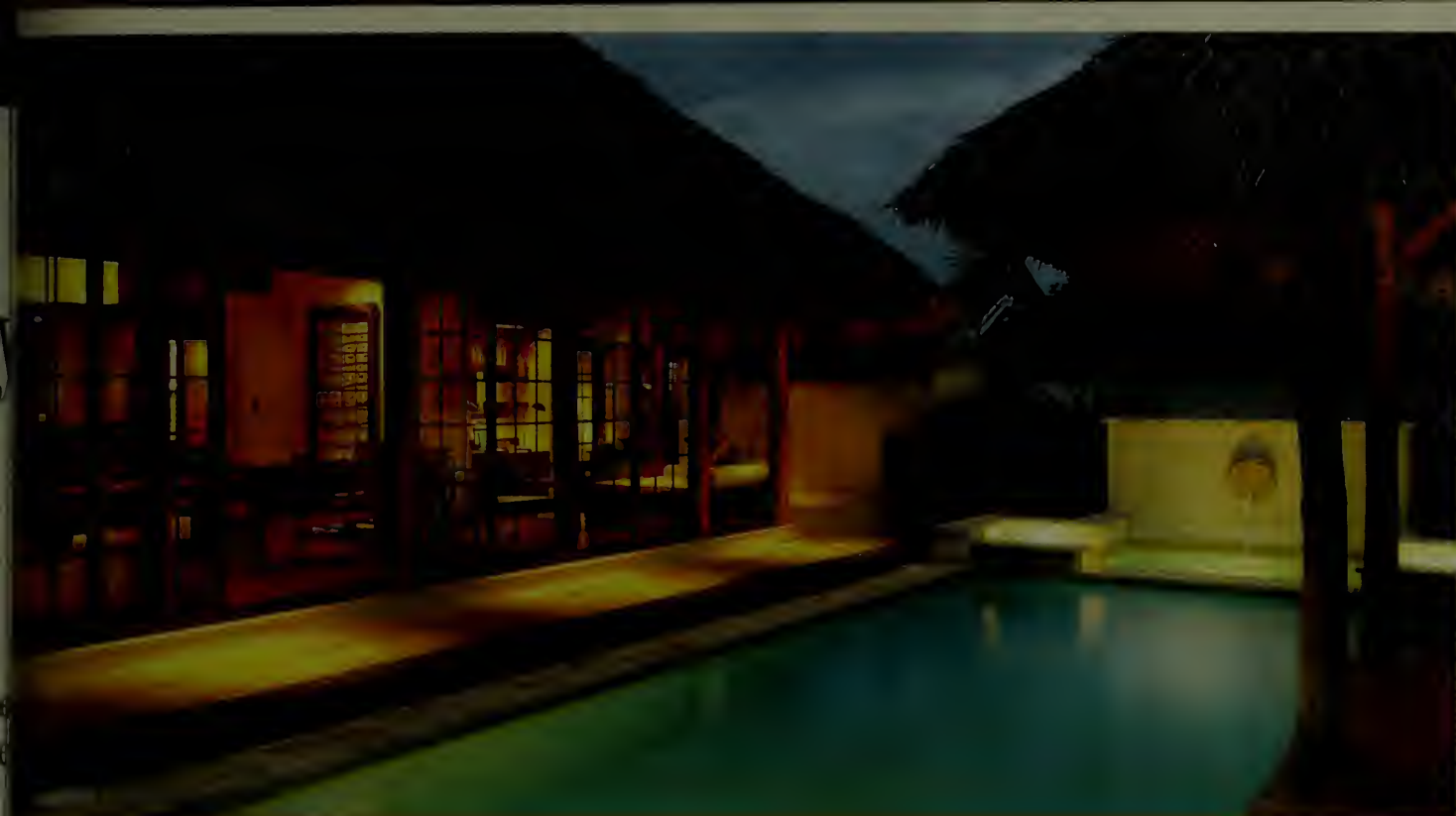
What is most disturbing is that the calls for aid could undercut efforts to liberalize trade. Poor countries face high

High-profile proposals to boost aid seem like political one-upmanship

tariffs, quotas, or subsidized competition from rich nations in industries such as food processing, textiles, and agriculture. The World Bank estimates that a substantial dismantling of these barriers could be worth \$350 billion to the developing world in the next decade and could lift 144 million people out of poverty. Reducing trade barriers would also help consumers in the industrialized nations.

Trade protection in the U.S., Europe, and Japan from agricultural subsidies alone amounts to \$1 billion a day. Global trade negotiations are moving at snail's pace, and they don't adequately address some of the most important impediments to development and poverty reduction—such as the provision of cheap medicines. Too little technical assistance is being provided to poor countries to allow them to maneuver effectively through the complex procedures of the World Trade Organization. The question shouldn't be aid or trade but the relative emphasis given to each. Right now, the scales are becoming dangerously imbalanced. ■

Jeffrey E. Garten is dean of the Yale School of Management (jeffrey.garten@yale.edu).



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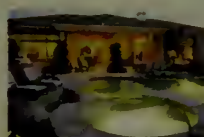


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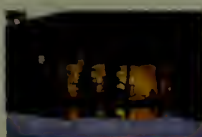
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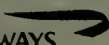


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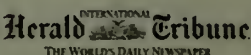
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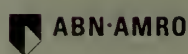
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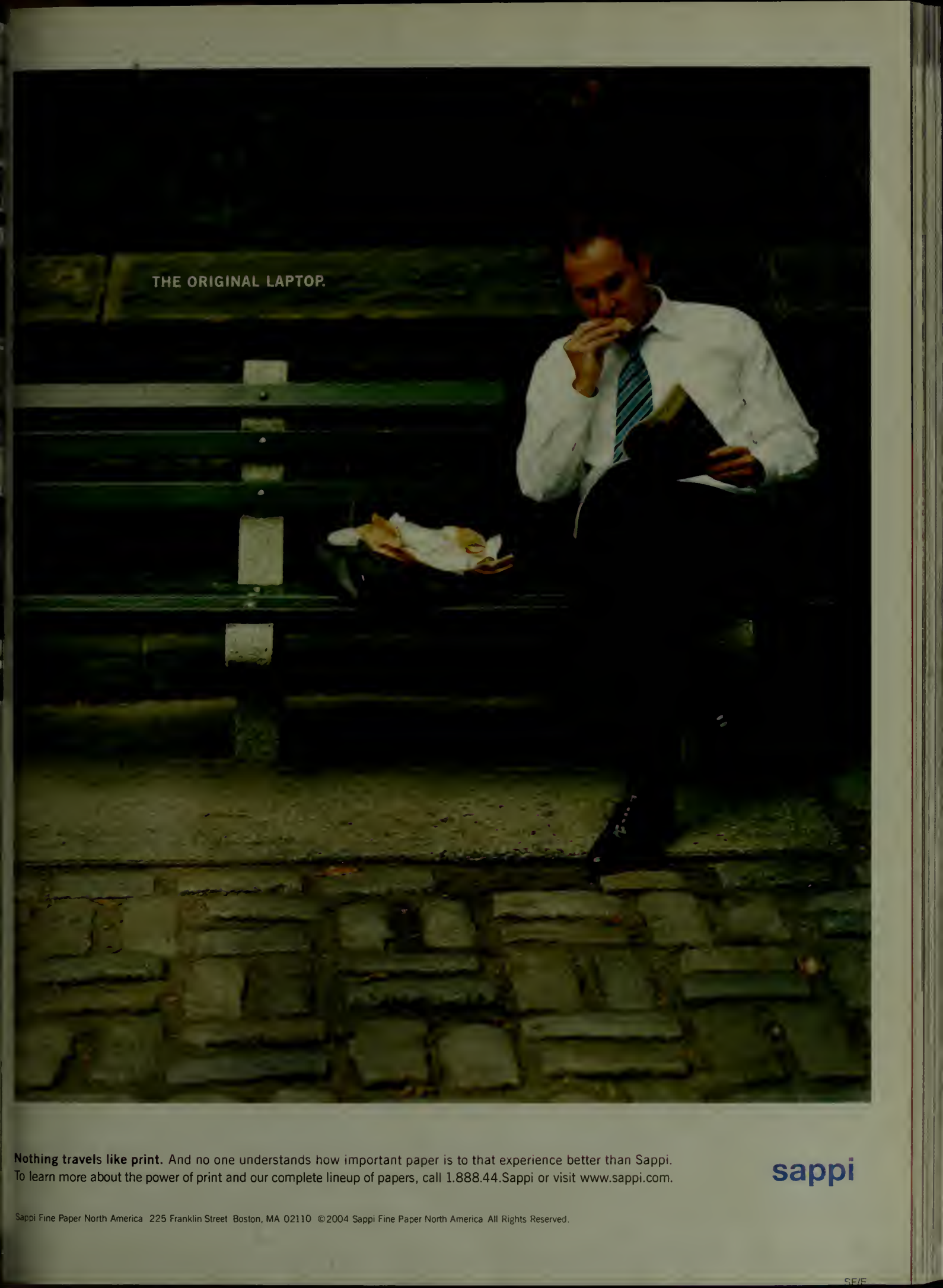
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BY JAMES C. COOPER & KATHLEEN MADIGAN

Oil Could Have Global Growth Over a Barrel

slowdown would affect the U.S. trade deficit at just the wrong time

U.S. ECONOMY Will global economic growth slip on another oil tick? That's a rising worry now that the price of petroleum has tipped back over \$50 per barrel. For the U.S., strong income growth and sizable profit margins should enable consumers and businesses to weather the price rise. After all, the 2004 jump in energy costs caused

the loss of momentum overall, although lower-income families were hit hard. However, this latest spike could pose a risk to the outlook if foreign producers react to their own slowdown in domestic demand by attempting to offset that weakness through increased exports. America's worsening trade deficit could trigger greater volatility in the dollar and global financial markets.

The markets' increasing nervousness was evident on Feb. 22. After a later-discounted report came out that the Bank of Korea would diversify its foreign reserve holdings, the dollar fell sharply in currency markets. Gold and oil prices rose and stock prices plunged. The Dow Jones Industrial Average lost 174 points on the day, its worst loss in nearly two years. Stocks rebounded somewhat the next day, but oil remained above \$50 (chart).

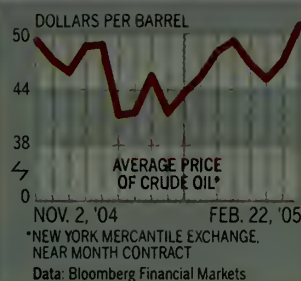
This latest oil price rise comes at an especially bad time because some industrialized economies unexpectedly contracted in the fourth quarter. Japan's real gross domestic product fell at a 0.5% annual rate. Most of the weakness was weather-related: Three typhoons hit the nation in the fourth quarter. But the decline followed drops in real GDP in both the second and third quarters. In Germany, real GDP fell at a 0.9% annual rate in the fourth quarter as domestic demand fell 0.8%. Also in the euro zone, Italy said its real GDP fell at a 1.2% annual rate year-end. Meanwhile, monetary policymakers in Canada and Britain are hiking interest rates in an attempt to slow their economies.

For those countries struggling with growth, the problem is weak domestic demand, whether from high unemployment, business uncertainty, or the need to fix growing fiscal budget deficits. According to the consensus forecasts compiled by *Blue Chip Economic Indicators*, before the latest oil rise, growth among the developed nations will be slower this year than it was in 2004. Now, global economies must also deal with the potential drag coming from continued high oil prices.

FOR EUROPE AND JAPAN, past currency movements mitigate some of the problem. That's because oil is priced in dollars, so their currencies' strengths offset some of the rise in energy costs. And Canada and Britain are energy producers who benefit from higher prices.

For emerging economies, however, the recent rapid rise in oil prices could exert a bigger drag on growth. First, many emerging nations, especially in Asia, have linked their currencies to the dollar or have accumulated massive amounts of reserves to stem the rise of their currencies. So these economies will feel almost the full brunt of higher oil costs.

A WORRY FOR GLOBAL GROWTH?



than they will elsewhere. Consequently, higher oil prices are a bigger drag on domestic demand.

In the past, the response of many countries faced with slower domestic spending was to export their way to faster growth. Most often, that meant shipping goods to the U.S., the world's biggest purchaser of imports.

AND CLEARLY, the U.S. is growing at a fast enough clip that imports will continue to increase. Although total retail sales slipped in January, nonauto sales grew at a solid rate, and weekly reports on store sales show the gains continued into February. According to the Conference Board, consumers in February were more optimistic about the current state of the economy than they were in January. In fact, the board's index of consumer confidence for the present-day economy is finally back up to where it was before the September 11 terrorist attacks.

At the same time, businesses look more confident about the economy's direction. That can be seen in their willingness to green-light capital projects and build up inventories. The monthly data show growth in business

inventories has been particularly stunning. In the fourth quarter, stockpiles grew by 7.8% from year-ago levels, the strongest pace in almost a decade (chart).

Faster inventory accumulation, along with increased consumer and business demand, makes it more likely that imports coming into the U.S. in 2005 could keep rising at the 10% pace seen in 2004. And while that will fit in well with the game plan of any foreign economy that wants to export more, the danger is that the never-ending flow of imports will worsen the huge U.S. trade imbalance.

ALREADY, ANALYSTS WORRY about what the U.S. can do to at least stabilize its current-account deficit, which probably hit 6% of GDP in the fourth quarter. But if imports keep growing at a double-digit pace this year, the trade deficit of goods and services will grow larger, not hold steady. Given that imports outnumber exports by 3 to 2, price-adjusted exports would have to surge by 15% just to keep the gap steady, with a 10% gain in imports. The last time real exports grew even close to that rate was back in 1997. And world growth clocked in at 4.2% then, much faster than what economists expect for 2005.

So far, of course, foreigners have been willing to finance America's huge trade gap. That partly reflects the better rates of return in the U.S. compared with other countries. But much of the financing by foreigners is in their own self-interest. By buying U.S. securities, foreigners provide the funding that enables the U.S. to keep buying their goods.

The unknown is this: At what point does the U.S. trade

deficit get so high that investors turn away from the dollar? Up to now, the dollar's decline has been orderly, so that investors have absorbed its impact gradually. But as the Feb. 22 markets showed, a run on the greenback would have immediate negative impacts.

Inflation expectations would most likely rise sharply.

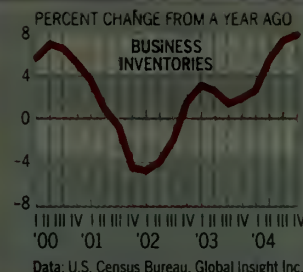
Long-term interest rate which have remained relatively low despite the six rate hikes taken by the Federal Reserve, would spike higher, sapping much of the energy from housing and autos. With borrowing costs rising, prospects for the federal deficit would worsen.

That could throw a wrench into any attempt to reform Social Security

since the plans under discussion have included massive upfront government borrowings. And the stock market would react negatively as well, rattling investor confidence and cutting into household wealth.

Right now, prospects for such a severe financial dislocation look small. But the uncertainty over energy prices raises a new concern for the outlook. Global growth could be slower than expected just when the U.S. needs to begin remedying its huge trade imbalance with the rest of the world. ■

INVENTORY GAINS ARE FUELING GROWTH



MEXICO

It's Hot South of the Border

FUELED BY high oil prices, rising exports, and positive developments at home, Mexico's economy is growing at its fastest pace in five years.

In 2004 real gross domestic product expanded by 4%, the strongest growth since 2000, when the U.S. tech boom contributed to a 6.6% surge in Mexico's economy. Economists say Mexico could grow by as much as 4.5% this year.

A healthier U.S. economy is lifting exports. The *maquiladoras*, Mexico's for-export-only factories, increased production by 24% over the year ended in November and added 84,000 jobs. Mexico's total industrial output in December was up 3.8% from a year ago.

In addition, domestic demand is rising. Consumer credit is expanding because of increasing competition among mostly foreign-owned banks in Mexico, which are aggressively marketing credit cards and auto loans. Last year Mexicans bought a record 1.1 million vehicles.

Consumer demand also got a boost from a record \$16.6 billion sent home by millions of Mexican workers in the

U.S., a 24% rise over 2003. Such remittances are now the country's second-largest source of foreign funds after oil exports. Reflecting the positive economic data, the Mexican stock exchange is up around 6% so far this year, and 36% over the past 12 months.

Despite solid

demand growth, inflation, which last year slightly exceeded the government's target of 4%, may be slowing: Consumer prices did not increase at all in January, thanks to a drop in key farm products such as tomatoes.

Meanwhile, a 27% jump in oil revenues has boosted the country's international reserves to around \$62 billion. That extra revenue, along with the Mexican government's prudent spending patterns, should allow the country to keep its fiscal 2005 deficit at a manageable 0.22% of GDP. And investment-grade-rated Mexico tapped low U.S. interest rates last year to refinance much of the debt falling due over the next two years. That move could be helpful in 2006, just in case the upcoming presidential elections contain any surprises or spark political unrest that might make investors jittery. ■

—By Geri Smith in Mexico City

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THE ECONOMY

IS THAT A WHIFF OF INFLATION?

The forces that have held it back are starting to move in another direction

STRONG GROWTH AND low inflation have become ingrained in the way most analysts view the U.S. economy. This win-win combination was a hallmark of the late 1990s, and it has been true for the past two years. However, the ground is slowly shifting, and the forces that have held inflation down for so long are starting to move in the opposite direction.

It's not as if inflation is about to skyrocket. Competition is too intense to allow that. However, some caution flags are popping up. Most important, labor markets are tightening, the dollar has fallen for three years, to a seven-year low, and productivity growth has slowed sharply. Why is this important? Because when the

labor markets were tightening in the late '90s, it was a rising dollar and strong productivity growth that held inflation in check. If the economy is as solid as recent data suggest, then 2005 will offer a crucial test of just how much this new age of global competition can continue to keep price pressures under wraps.

HOW RESILIENT?

BOTH FEDERAL RESERVE policymakers and bond investors have a lot riding on the outcome. Right now, the Fed and the bond market seem pleased with the economy's resiliency. But the next few months could test both the bond market's contentment and the Fed's gradualist approach to tightening policy. The Fed's six rate hikes since last June have had almost no impact on the bond market, a key fac-

tor that has kept borrowing costs unusually cheap for home buyers and businesses. But the minutes of the Fed's Feb. policy meeting showed some concern among some policymakers that the declining dollar and higher unit labor costs could heat up price pressures.

The minutes also suggested that the pace of further hikes will depend greatly on how the economic data shape up. That front, although the economy was expected to cool off a notch this winter, January and February data from housing starts to factory output to retail sales show little, if any, loss of momentum. That suggests real gross domestic product could be expanding close to its roughly 4% annual

HOW LONG
can global
competition
contain price

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rate of growth posted in the second half of 2004, a pace that will continue to imply strong demand and tighter job markets.

Already, the news on inflation is starting to hint that demand is robust enough—and the dollar low enough—to generate upward pressure on goods prices. A return to \$50 oil in recent days and new jitters over the dollar have made matters worse in the financial markets. Stock prices plunged on Feb. 22, with the Dow Jones industrial average suffering its worst loss in nearly two years on fears that costlier oil and a sinking dollar would fuel inflation. Bond prices also buckled, pushing the yield on 10-year Treasuries to a six-week high of 4.29%.

But the number that drew everyone's attention most recently was the 0.8% surge in the January producer price index for core finished goods, which excludes energy and food. True, several apparent one-time price jumps for cigarettes, alcoholic beverages, and automobiles were factors, but those gains do not explain all of the unexpected increase. "People are paying a lot more for our products than they have in a long, long time," says Andrew N. Liveris, CEO of Midland (Mich.)-based Dow Chemical Co., the country's largest chemical maker. Dow has raised many prices by more than 30% over the past year and has no plans to stop.

Rising business confidence and the capital-spending boom are also pushing up prices for basic equipment. Caterpillar Inc., the Peoria (Ill.)-based maker of heavy machinery and engines, also has been jacking up prices. It began the year with the third price hike in 12 months, so that its products now cost, on average, about 9% more than a year ago. "It's our plan to more than offset material cost increases with prices in 2005," says Douglas Oberhelman, Caterpillar group president.

Higher import prices, the result of the

EATON PLANT Strong demand is enabling it to pass on cost increases

dollar's three-year drop, were another driver for the PPI gain. Not only is the yearly inflation rate for nonoil imports up to 3%, from -5.1% at the dollar's peak three years ago, but costlier imports are also giving U.S. producers some leeway to lift the prices of their own goods as well. For now, that's mostly true in the area of raw materials and supplies used by U.S. manufacturers.

Take Eaton Corp., a diversified manufacturer headquartered in Cleveland. Last year, its outlays on steel and other metals jumped by \$140 million. The company was able to offset only about half of that through other cost cuts and some price increases and had to take the rest out of profits. It doesn't intend to do that again this year. With others making similar moves, government data show that prices of semifinished goods, even excluding energy and food, jumped sharply in January, and their yearly inflation rate is now 8.5%, the highest since the early 1980s.

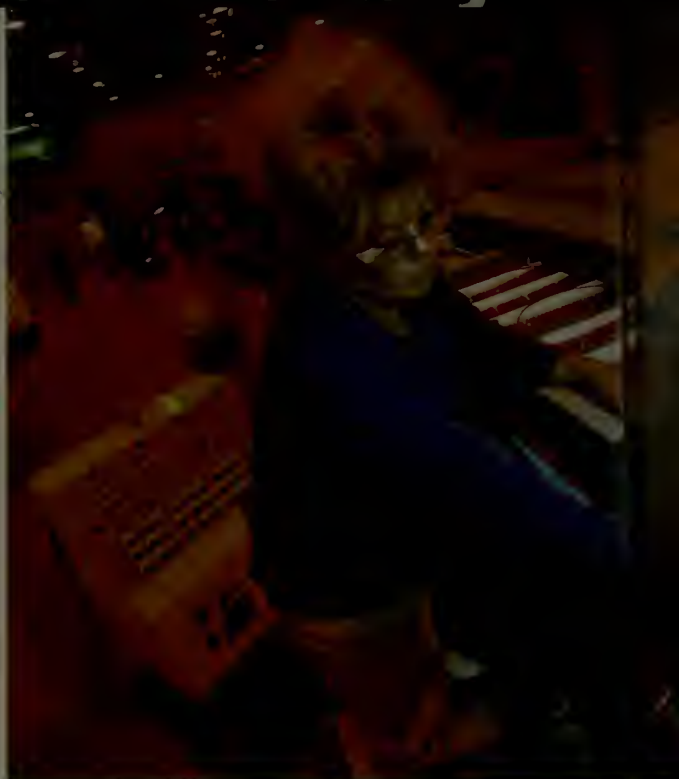
THE 'CHINA EFFECT'

OF COURSE, A LOT HAS changed since the early '80s. Passing those costs through to consumer prices is much more difficult today in the face of intense global and domestic competition. Despite the dollar's drop, prices of imported consumer goods, excluding autos, are up a scant 0.8% from a year ago, and imported

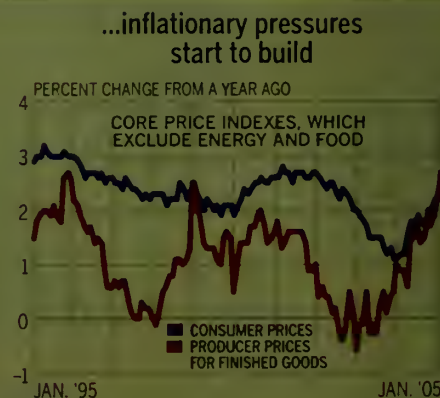
autos are up only 1.6%. That partly explains why, despite the PPI jump, the January consumer price index rose a scant 0.1%. Even stripping out energy and food, which often say more about supply conditions than underlying inflation pressures, the CPI rose only a tame 0.2% for the fourth month in a row.

So far, the "China Effect" has been the biggest factor holding back overall import prices, reflecting China's rigid currency peg to the dollar. During the past year, prices of imports from industrialized nations are up 6.7%, but prices of Chinese imports are down 0.7%. Any revaluation of China's currency could have a sizable impact on overall import prices—and U.S. inflation.

Even Fed Chairman Alan Greenspan noted in his Feb. 16 congressional testimony that foreign exporters to the U.S. have



CAUTION FLAGS FOR HIGHER INFLATION



reached the limits on how much they can absorb the stronger dollar in their profit margins, suggesting that more rapid increases in import prices could be on the way.

The other caution flag is the slowdown in productivity growth at a time when job markets are finally beginning to tighten. In 2004's fourth quarter, output-per-hour-worked rose by just 0.8% at an annual rate. Although that number is likely to be revised a shade higher, productivity gains for all of 2004 will probably average about 2% per quarter, the slimmest average in four years. For the Fed and the bond market, the question is whether the ef-

ciency slowdown will cause unit labor costs to rise to the point that businesses feel the need to raise prices to hold their profit margins. Already, the growth in labor costs has outstripped productivity gains in each of the past three quarters, the first time that has happened in five years.

With productivity slowing, businesses will have to add to their payrolls at a faster clip to meet increased demand. Plus, the labor market may well be tightening faster than recent job data suggest. New unemployment claims this year have moved sharply lower, with new filings in mid-February hitting their lowest level in more than four years. Moreover, the Conference Board's February survey of consumer confidence showed that the percentage of consumers describing jobs as "hard to get" fell to the lowest level since 2002. Households also described present economic conditions as the best in 3½ years. Based on past trends, a surge in consumers' assessment of current conditions has always been linked to a pickup in job growth, and job trends will weigh heavily on both wage growth and the Fed's future interest-rate moves.

To be sure, globalization continues to be a formidable force holding back U.S. inflation pressures. But this year, the economic winds are gradually beginning to blow in the other direction. How strong those gales turn out to be will determine whether the economy faces clear sailing or rough seas. ■

By James C. Cooper and Kathleen Madigan, with Michael Arndt in Chicago and Rich Miller in Washington

CURRENCIES

Who Wants China's Yuan To Rise?

Beijing, please do something—anything!—about your rigid currency regime and let the yuan appreciate. That's the message Washington, Tokyo, London, and others have been blasting at the Chinese government for months now. With politicians worldwide calling on China to revalue the yuan, you'd think the big corporations headquartered in their countries might be just as adamant. But you'd be wrong. Most Western multinationals with operations in China couldn't care less about reform; they like the yuan right where it is.

To understand why, you have to crunch a few numbers. About 55% of China's \$593 billion in global exports last year came from foreign-run enterprises. The \$160 billion-plus U.S. trade deficit with China gets a lot of press, but China imported \$561 billion worth of goods last year—so its overall trade surplus stood at a relatively modest \$32 billion. Consider, too, that \$60 billion in foreign direct investment streamed into China in 2004. A cheaper yuan means cheaper land and labor and more competitively priced China-made exports. "Given the importance of China as our production base, we don't want a sudden change in the value of the yuan," says a senior executive with Seoul-based LG Electronics, which makes everything from microwave ovens to mobile phones in China, sourcing 90% of its parts locally and exporting 60% of its production.

Major U.S. business groups have come to nearly the same conclusion. "We don't really have a point of view" on revaluation, says Emory Williams, chairman of the American Chamber of Commerce in Beijing. Translation: Its biggest members don't give a hoot. And the U.S.-based National Association of Manufacturers pulled out of a campaign to sanction China

for violating trade laws by currency manipulation, in part because its members have sunk billions into the mainland.

That's not to say no one in U.S. or European business is worried about the yuan. Plenty of smaller companies have been devastated by competition from Chinese imports. Think U.S. furniture manufacturers, developing-nation textile makers, and European electronics

suppliers. If they haven't transferred at least some production to China, they can't beat the prices offered by Chinese rivals.

But multinationals that both source and sell in China have little cause for concern. For the biggest companies, a stronger yuan would be a wash. It would lower costs by making imported parts cheaper, but increase the selling price (and, presumably, curb demand) for products made in China. "We are a global company with a lot of

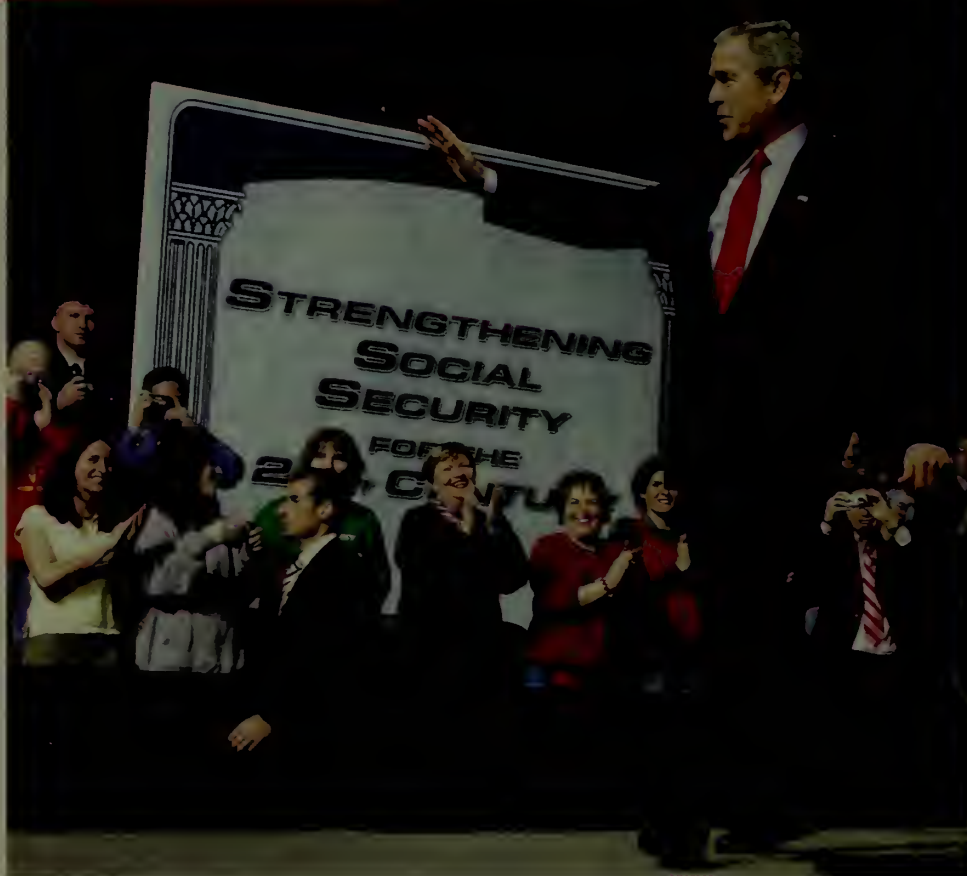
manufacturing and research and development in China, and we also sell a lot there," notes Motorola Inc. CEO Edward J. Zander, who says his company isn't lobbying for Chinese currency reform.

For now, this means Beijing isn't likely to face the kind of pressure most likely to force a revaluation. Sure, Washington and others will continue to jawbone the Chinese. But unless the big multinationals start to squawk—which is unlikely—don't look for any more dramatic action such as punitive tariffs against Chinese exports.

There's plenty for big corporations to fret about in China: intellectual property theft, tax policies that favor Chinese competitors, and easy credit to locals from Chinese banks—which could slam margins by creating overcapacity in autos, steel, and appliances. It's just that a cheap yuan is far from the top of the list.

—By Brian Bremner, with Andy Reinhardt in Cannes and Moon Ihlwan in Seoul





SOCIAL SECURITY

A TRIAL BALLOON THAT'S DROPPING FAST

Bush's hints about higher payroll taxes spook supporters and don't sway Dems

WHEN PRESIDENT George W. Bush hinted on Feb. 15 that he might be willing to raise payroll taxes on upper-income workers as the price of a broader deal to overhaul Social Security, some reform backers cheered. They reckoned that adding new revenues to the shaky system not only made financial sense, but it would help win over a handful of swing Senate Democrats and balky Republican moderates. Until now those lawmakers have opposed the President's plan for private investment accounts, fearing that the cost would bust the budget and require deep benefit cuts. A tax hike

could ease both concerns. Says Maya C. MacGuineas, president of the Committee for a Responsible Federal Budget: "It is a huge act of good faith for the President. This needed to be on the table."

Problem is, Bush's trial balloon has not

Payroll Tax Tightrope

To win support for private accounts, Bush says he may agree to raise the cap on wages subject to the payroll tax above \$90,000. How would that play out?

OMAHA Polls show no boost for private accounts despite the President's tour

yet helped much Moderate Democrats show no sign of softening the opposition to

Bush's accounts. Business lobbyists are reacting coolly to the prospect of a bigger tax bite. Senate GOP moderates are unwilling to embrace it, though the idea was floated by one of their own, Senator Lindsey Graham (R-S.C.) And Hill conservatives are responding with rare criticism. "I don't think it moves the ball at all," says Stephen Moore, president of Free Enterprise Fund, a Washington advocacy group that favors personal accounts.

BREAKING RANKS

STILL, SOCIAL SECURITY reform is far from dead. Time and again Bush has proven his skill at muscling through his agenda, be it tax cuts or education reform. But given the complexity and passion surrounding the Social Security debate, even some of his strongest allies wonder if he can sell his plan in 2005. Every hint of either benefit cuts or tax hikes generates furious opposition. And polls show the President's cross-country tour has no boosted support for private accounts a bit.

Bush's willingness to consider raising payroll taxes is clearly aimed at winning wider support. Graham and others suggest making wages above \$90,000 subject to Social Security tax. Today workers pay tax on their first \$90,000 in annual salary and nothing on wages beyond that. A Feb. 4-6 CNN/USA Today/Gallup poll shows that such a tax hike may be the most popular solution to the system's financing woes. More than two-thirds of those surveyed said higher-income workers should pay tax on all their wages. Seniors' lobby AARP also would back such a hike as part of a global fix. And some economists believe it should be part of any long-term solution.

But House Republicans are not buying. Both Speaker Dennis Hastert (R-Ill.) and Majority Leader Tom DeLay (R-Tex.) flatly reject the idea. And though the White

PROS

The idea could attract the backing of Senate Democrats, organized labor, senior groups, and some moderate Republicans by reducing the need for benefit cuts or government borrowing to fund private accounts.

CONS

It would be opposed by Capitol Hill conservatives, who reject tax hikes of any kind. Many employees are also wary because they would pay half the tax increase, fearing to their cash flow.

House asked GOP lawmakers to hold their own meetings on Social Security during the week of Feb. 21, only a third of the party's House members were expected to do so. "The President still needs to convince people there's a problem," says one House GOP staffer.

As part of that effort, Bush is enlisting business. Such groups as the National Association of Manufacturers and the U.S. Chamber of Commerce may be key to the fate of Bush's private accounts since they aim to contribute up to \$100 million for both a massive grassroots public relations blitz and an inside-the-Beltway lobbying effort. But many businesses are far from enthusiastic about the effort. Some say they're participating only because they've been pressed by the White House. They're making a list," says one lobbyist. "They're checking it twice."

Now these execs are starting to worry about getting socked with a payroll tax increase. And business is quietly urging the White House to scrap the idea. Still, corporate America will wait to see what Social Security deal looks like before making any commitments. "We'll have to look at that when it comes forward," says John J. Castellani, president of the Business Roundtable, which leads one grassroots initiative.

Senate Democrats, meanwhile, continue to oppose any accounts that reduce basic benefits. And no Democrat will back specific benefit cuts or tax hikes until Bush unveils his own plans. But moderates are leaving the door open to a deal. "The fact that he did not object to raising the cap is very important," says one Senate Democratic aide.

That still leaves Bush with a Gordian knot that is tightening around his plan for Social Security. He can't win without Senate Democrats—but he can't get them on board without upper-income tax hikes and without dropping his version of private accounts. But Bush also needs the backing of House Republicans—and he can't get them if he abandons his accounts and includes tax hikes.

That painful calculus may explain why the President took time out from his Social Security blitz in late February to travel to Europe. Patching up the trans-Atlantic alliance could prove far easier than fixing Social Security. ■

—By Howard Gleckman
in Washington

GUEST COMMENTARY

BY PAUL CRAIG ROBERTS

Private Accounts: Right Idea, Wrong Time

Why a longtime advocate isn't backing Bush's plan

PRESIDENT GEORGE W. Bush's plan to privatize Social Security is as ill-considered as his "cakewalk" invasion of Iraq. This is a hard admission for an economist who has long beat the drums for Social Security privatization. What has happened to change my mind?

A privatization scheme launched early in President Ronald Reagan's first term would have had a 20-year financial market boom to underwrite the shift. The 1980s and 1990s were also periods of strong employment growth, which would have helped generate the payroll revenues needed to fund the transition. The U.S. had not amassed the massive trade deficits that now undermine its capacity to issue trillions of dollars in new debt, and it had not launched a costly war in the Middle East.

Strike One against Bush's plan is the inability of the weakening dollar to carry the debt burden required to finance the transition to privatization. Foreigners are drowning in dollars.

With the U.S. economy in relative decline, they have no appetite for additional trillions of dollars. The greenback has weakened so much that it's on the verge of losing its status as a reserve currency.

Strike Two is the lack of domestic savings that would fund the shift. The U.S. personal savings rate is practically nonexistent, and the government budget is awash in red ink. Offshore production, job outsourcing, and the proliferation of H-1b and L-1 work visas for foreign professionals have brought a halt to the growth in the high-value-added, high-productivity jobs that permits household saving.

During the past four years the U.S. experienced a net loss of 760,000 private-sector jobs instead of a normal gain of millions of new jobs. Moreover, employment has shifted away from jobs in export- and import-competitive goods and services sectors. The Bureau of Labor Statistics payroll data show that the economy has been able to create jobs (although not net new jobs) only in lower-paid, domestic services that cannot be moved abroad. The BLS predicts that the vast majority of new American jobs in the next 10 years will not require a university education.

The trend toward lower-paid jobs means lower incomes, especially as the weak dollar begins to hurt domestic prices.

Some 70% of Wal-Mart Stores Inc.'s goods come from China. When China is no longer able to maintain the unrealistic undervaluation of its currency, Wal-Mart's prices will rise. A population that



**Bush's
initiative is as
ill-considered
as his
"cakewalk"
war in Iraq**

is subject to these pressures—and loaded up with debt—is not a high-saving society.

Strike Three against Bush's plan is that the drive for revenues will likely result in raising the "cap" on withheld wages and salaries above the current level of \$90,000. Assuming that the Social Security tax rate remains the same—and leaving aside the fact that the 50% share of payroll taxes paid by employers are deductible—raising the cap will translate into a marginal tax rate increase of 12.4 percentage points on all income up to the new cap.

Backdoor Hike

CONSIDER, FOR EXAMPLE, a person earning \$500,000 a year. Removing the cap entirely would extract an additional \$50,840 annually in Social Security tax. Even simply lifting the cap would result in a hefty hike. A cap of \$110,000, for example, would boost taxes on everyone earning that sum by \$2,480. Unless the benefits are increased proportionally, the scheme is nothing but a backdoor marginal tax rate hike that makes a mockery of the President's tax rate reductions.

Social Security can be fixed without raising taxes or saddling the dollar with a debt burden it cannot sustain. In 1981, Deputy Assistant Treasury Secretary Stephen J. Entin produced a plan that eliminated the Social Security shortfall by changing the initial benefit formula from wage indexing to price indexing. Real benefits would still rise, though more slowly. If U.S. wages continue to outpace prices, the Treasury's 1981 plan would work today. But if the developments discussed above cause prices to outpace wages, leaving the benefit formula unchanged would correct the problem. In other words, indexing to whichever is growing at a slower pace—wages or prices—would be a surefire solution.

The Treasury's plan was preempted by then-Budget Director David Stockman and current Federal Reserve Chairman Alan Greenspan, who used the Social Security Commission to accelerate Social Security tax increases for the purpose of reducing federal budget deficits. Let's hope the current Social Security "fix" doesn't become just another revenue grab. ■

—Paul Craig Roberts is a former Assistant Treasury Secretary in the Reagan Administration and a former BusinessWeek columnist.

PHARMACEUTICALS

A DRUG COMPANY ON GROWTH HORMONES

With its new acquisition, Medco gains a strong presence in medical innovation

WHEN MEDCO HEALTH Solutions Inc. was part of drug giant Merck & Co. in the 1990s, investors paid scant attention to the pharmacy benefits unit. After all, it was a low-margin group with a less-than-sexy business: managing pharmacy benefits for big employers and health plans. That's one reason Merck ended up spinning the company off to shareholders in August, 2003.

Investors sure aren't blasé these days. Since the spin-off, Medco's stock is up over 87%, thanks to a host of developments including a growing mail-order drug operation, the expectation of new Medicare business, and the anticipated benefit of increased generic drug use. And now, with the company's announcement on Feb. 23 that it would pay \$2.2 billion for specialty pharmacy services company Accredo Health Inc., Medco is moving forcefully into the rapidly growing market for expensive biotech medications.

Paying a 43% premium for Accredo, Medco isn't getting any bargain. And investors sent Medco's stock down slightly on news of the deal. But they give Medco Chairman and Chief Executive David B. Snow Jr. credit for putting Medco in a position to capitalize on new opportunities.

FAT MARGINS

IN ACCREDO, MEDCO is getting a small but fast-growing business that boasts healthy pretax margins of close to 8%, compared with Medco's overall margins of around 2%. What's more, biotech accounts for an increasing share of medical innovation. By adding Accredo to its portfolio, therefore, Medco

gains a strong presence in the area specialty drugs.

Snow, who joined Medco from New York insurer WellChoice Inc. a few months before the spin-off, clearly thinks Medco's newfound independence has a lot to do with its strong performance. There's no doubt that when Medco was a unit of Merck, potential customers were concerned that Medco's first priority was pushing Merck drugs.

Medco has long maintained that it operated with a free hand, but pharmaceutical benefits units "should not be owned by pharmaceutical manufacturers," asserts Snow. "If Medco had planned

to stay under Merck, we would not have agreed to be its CEO."

Medco now has the ability to fully exploit major shifts in the drug business. One of the biggest: patent expirations on blockbuster pharmaceuticals.

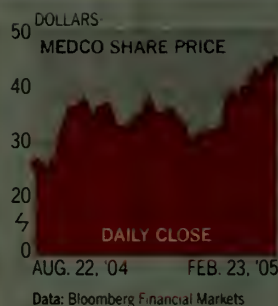
2006, drugs generating \$12 billion in sales will lose patent protection. And Medco, which has more bargaining power

with the smaller generic companies than with the big branded drugmakers, enjoys margins that are three times greater on generic drugs than on branded products.

Plenty of hurdles lie ahead. For one, legal issues continue to hover over pharmacy benefits managers. Medco is still fighting the U.S. Attorney's Office in Philadelphia in a case that centers on regularities in the management of a contract with the federal government. Snow says Medco is prepared to fight that case in court. "Some of the biggest challenges are behind us," Snow argues. Being owned by a giant drugmaker may have been one of them. ■

—By Amy Barrett in Philadelphia

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COMMENTARY

BY JOHN CAREY

Side Effects of the Drug Scares

New fears give rise to a more honest look at the risks for a pill-popping nation

IT'S ENOUGH TO MAKE your head spin. In September, Merck & Co. pulled its blockbuster painkiller Vioxx from the market because a study linked it to heart attacks and strokes. Another study fingered Celebrex, a similar drug made by rival Pfizer Inc. The Food & Drug Administration quickly came under attack for failing to protect the public from these dangerous drugs. At a

three-day FDA advisory committee hearing in late February, 32 outside experts agreed that these relatively new nonsteroidal anti-inflammatory drugs (NSAIDs) do pose serious risks.

But wait. Despite the hazards, the panel also concluded that some older NSAIDs could be just as dangerous as Celebrex—and that all should stay on the market. The committee even decided that Vioxx, which may have caused thousands of deaths, is useful enough that it shouldn't be banned.

Is this Solomonic wisdom or simply more confusion? Both. The saga starkly illuminates larger underlying problems in drug regulation and use—and the implications go far beyond painkillers. Here are some of the key insights and issues:

MEDICINES ARE NEVER HARMLESS

"Clearly all drugs have risks. That is the price we pay for the benefits," says Dr. Alastair J.J. Wood, associate dean of the Vanderbilt University Medical Center and chair of the advisory meeting. That point has been often forgotten as new drugs appear on the market promising to make life better for tens of millions of Americans. And while the FDA is charged with ensuring that benefits exceed the risks, it's not easy to do. Even when done right, people will be hurt. "Drugs may have a positive risk balance but cause grievous harm," says Dr. Steven Galson, acting director of the FDA's Center for Drug Evaluation & Research.

A classic case: The agency yanked Lotronex, GlaxoSmith-Kline PLC's drug for irritable bowel syndrome, off the market in

2000 after five deaths—only to allow limited use two years later when patients demanded it. The thorny question for the Cox-2 painkillers like Vioxx is whether reductions they may offer in stomach and intestinal bleeding, compared with older NSAIDs, outweigh their increased cardiovascular risks.

KNOWLEDGE GAPS MAKE THE TASK HARDER "For most drugs, we know little about how well they work and less about how safe they are," says Dr. David J. Graham, the FDA drug safety official who helped blow the whistle on Vioxx. The FDA's advisory committee was faced with the uncomfortable fact that the risks of the older NSAIDs aren't known either. In fact, epidemiological studies suggest that some of those drugs, such as celecoxib (Cataflam and Voltaren), meloxicam (Mobic), or even over-the-counter ibuprofen (Advil or Motrin), are as dangerous

as Celebrex. Putting limits or warnings on Celebrex thus "risks bringing about an enormous migration from this drug to others we don't know much about," warned New York University rheumatologist Dr. Steven Abramson at the hearing.

PATIENTS MISCALCULATE THE ODDS

Studies show that people typically overestimate the benefits of drugs and underestimate their risks, especially for heavily advertised medicine. That's why direct-to-consumer advertising contribute to the mistaken notion that there is a safe pill for every problem. The FDA's Cox-2 panel called for an end to ads for the drugs (page 45).

ANSWERS ARE HARD TO COME BY

Feb. 16, another FDA panel advised putting black-box warnings—the strongest possible—on two eczema creams: Novartis' Elidel and Fujisawa's Protopic. Recent monkey studies showed that the drugs, which suppress the immune system, may promote lymphoma. So will Elidel, the leading prescription

eczema drug in the U.S., cause cancer? We won't know unless researchers follow its users for years or decades.

Rare cancers take years to develop, but at least an increase in cases is relatively easy to spot. Uncovering dangers with Cox painkillers is tougher, because heart attacks and strokes are common. And the increase in risk seen in the studies is small. Often doctors don't consider a safety problem proven unless there is a two- or three-fold increase in a side effect, Dr. Robert J. Temple, FDA's associate director for medical policy, said. B





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with some of the painkillers, "we're talking about [10%] differences. What do we make of these small differences?"

To pin down the actual risk, a clinical trial would have to be long and huge. Vioxx and Celebrex can't be tested against placebos in arthritis patients, because it's unethical to deny these people pain relief. And testing newer drugs against older NSAIDs is problematic, since their risks and benefits aren't known. "Asking for clinical trials is not the answer," says Arthur Levin, director of the Center for Medical Consumers.

Is there a way out of this mess? Doctors need to better inform patients about risks

and benefits, and ads should be more balanced. But part of the solution is getting out the message that regulators don't have all the answers. One benefit of the meeting, says FDA's Dr. John Jenkins, is that "it's good for the public to see how the science evolves and how challenging these decisions can be." Agency watchers also see an increased willingness by the FDA to acknowledge uncertainty by slapping black-box warnings on drugs even when risks aren't proven. "Putting concerns on labels treats physicians and consumers in a more adult fashion," says pediatrician Dr. Richard Gorman.

The next part of the solution is work-

ing harder to get answers. The FDA should require companies to collect information on patients receiving medicines and put far more effort into analyzing the data. Beyond that, new genetic technologies offer the promise of being able to identify individuals who will be most helped or hurt by any particular drug. Until then, the best advice comes from Wood. "Hopefully this will make people think about taking any drug," says. All drugs are potent substances that must be used with respect and caution. The more we take that to heart, the safer we will be. ■

—With Kerry Capell in London

PHARMACEUTICALS

Will Drugmakers Back Off the Hard Sell?

The Food & Drug Administration panel charged with reviewing the safety of Cox-2 painkillers left little doubt as to where it stands on using advertising to sell the controversial class of drugs: It shouldn't happen—period. "The committee wanted to send a clear message that [consumer] ads for these drugs were inappropriate," said committee Chairman Dr. Alastair J.J. Wood on Feb. 18.

So will the uproar around Cox-2 drugs lead pharmaceutical companies to cut back the money they pour into consumer ads? Probably not. Despite criticism that excessive marketing of prescription drugs in the same breezy manner used to pitch beer or shampoo has led to their overuse, print and TV ads have become crucial to the drug-marketing machine.

Still, many experts foresee a return to more sober marketing messages. "The pendulum is swinging back," says Beth L. Miller, senior vice-president of Campbell Mithun, a unit of ad agency Interpublic Group of Companies. "I think [that drug] ads will become more conservative."

There is only so much the FDA can do about drug advertising. Even in a case like

ALLURING In the future, Cox-2 ads could carry severe warnings

the Cox-2 drugs—and armed with the panel's clear recommendation to end ads—the agency can't simply prohibit companies from advertising

certain drugs. That would require Congress to change the law. And imposing restrictions on ads would be dicey legally, since commercial free speech is strongly protected.

Still, regulators hardly remain powerless. They can follow the panel's recommendation and require the Cox-2 drugmakers to put a severe "black-box" warning about cardiovascular problems on their labels. That also would compel pharmaceutical companies to display these risks prominently in their ads. The agency says another option would be to negotiate

voluntary bans or limits on consumer advertising for those drugs.

Ultimately, the drugmakers control how and to whom they advertise—and they are loath to make big changes because consumer advertising routinely turns drugs into blockbusters. According to research by Meredith Rosenthal, an assistant professor

at the Harvard School of Public Health, for every additional dollar spent on consumer advertising in such big niches as antidepressants and anti-ulcer drugs, the product category reaps an extra \$4.25 in sales.

That helps explain why the drug industry shelled out \$4.4 billion in consumer advertising in the 12 months ending November, 2004, according to TNS Media Intelligence. That's a 57% leap from the \$2.8 billion spent just two years earlier.

Yet there are signs that industry executives are rethinking their pitches. Pfizer Inc.'s big spending on Celebrex—\$119 million over the 12 months ending in November—helped turn it into a blockbuster. But, for the industry as a whole, Chairman and CEO Henry A. McKinnell Jr. acknowledges a downside to the drugmakers' marketing successes. "We've managed with our advertising to create this image of a perfectly safe drug," McKinnell says. "And that is never true."

He argues that drug ads need to return to more balanced communication of risks and benefits and not depend so much on catchy phrases and images. The question is whether the industry is ready to take that lesson to heart.

—By Amy Barrett in Philadelphia

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COMEBACKS

IS HAVING MARTHA BACK A GOOD THING?

She'll be a bigger star than ever. But that may hurt her company's bid to grow beyond her

ON MAR. 6, AFTER HANGING up her prison garb, Martha Stewart will begin the next chapter in what's shaping up to be the most memorable comeback story in Corporate America in years. The domestic icon is, if anything, a bigger celebrity than before the scandal over her suspicious trading activity broke nearly three years ago, with a lofty price for her company's stock, two TV shows lined up, and surging public support. Donald Trump, who is co-producing Martha's version of his NBC prime-time hit *The Apprentice*, goes so far as to say: "I've gained more respect for her because of the dignity and style with which she has handled all this."

But Stewart's personal triumph is just that—personal. While the initial burst of publicity and enthusiasm will undoubtedly help her company, Martha Stewart Living Omnimedia Inc. (MSO), in the short term, it actually sets the company back in its most important goal: moving beyond Martha. The biggest risk for the company has always been its dependence on one individual—and an often polarizing 63-year-old individual at that. In its prospectus before its 1999 listing on the New York Stock Exchange, the company cited the fact that "Martha Stewart remains the personification of our brands" as a major risk factor. Executives said reducing that dependence was a key goal. Even without a felony conviction of the CEO, there was always the fear that MSO would simply be unable to outlive its celebrity founder.

Clearly, the company has yet to make great strides on that front. The blows that

Stewart suffered translated into immediate and sustained damage at her company. On Feb. 23, MSO announced a net loss of \$59.6 million on declining sales of \$187.4 million—its second straight year of red ink. Merchandising, the business least associated with Stewart herself, was the only segment to post even slight growth. Meanwhile, ad revenues for flagship *Martha Stewart Living* magazine dropped to \$71.7 million last year, less than one-third of what the publication hauled in during 2002. At the same time, average circulation fell from about 2.4 million to 1.9 million. Advertisers remain wary, says Jon Mandel, global buying officer of MediaCom Worldwide, because they're not yet sure if Martha mania will mean more readers.

TRIUMPH OVER ADVERSITY

LATELY, THOUGH, investors haven't seemed to care about all that. The stock has been trading wildly on speculation about Stewart's return, with daily volumes of more than 1.5 million shares despite the relatively limited public float of 20.7 million shares. Some feel that new Securities & Exchange Commission rules have put the squeeze on traders who were short-selling the stock, thus driving the price up. Few attribute it to long-term investors who have carefully evaluated the company's fundamentals.

Although Martha's prison stint did accelerate company efforts to acquire or develop secondary brands, the temptation now is to go back to being all about Martha. After all, she has legions of fans who are thrilled to see their heroine triumph over adversity. And despite efforts to promote other personalities within

MSO will get no income from her *Apprentice* episodes



MSO, such as pet expert Marc Morrone, no one has come close to achieving the same level of fame. To many, Martha is the underdog who's back to reclaim her rightful place in the kitchens and garden of America.

But even her most ardent admirers could grow weary. With so much Martha in the news and on the airwaves, there's a real risk of Martha fatigue, or even a



BIG PICTURE Lyne (below) aims to leverage Martha's library of recipes and shows and nurture new brands

her management style is a mistake."

That's why the real pressure isn't on Martha, it's on CEO Susan Lyne, an experienced media exec who took the position while Martha was in prison (page 88). Her goal is to build on the core brand while nurturing new franchises and partnerships. To help out, she brought in director Charles A. Koppelman—a music industry veteran who has advised such troubled clients as Michael Jackson and shoe entrepreneur Steve Madden—on a one-year, \$450,000 contract to help assess new merchandising and media deals.

STILL THE NO. 1 SHAREHOLDER

LYNE WANTS TO BUILD a lasting brand and talks about leveraging MSO's library of recipes, articles, TV shows, and other content, as well as nurturing new talent and attracting advertisers. Lyne, the former president of ABC Entertainment, is also building up brands such as Everyday Food, which now has a magazine and TV show, and properties such as *Body & Soul*, a natural-lifestyle magazine MSO bought last year that relaunches in April. "The challenge is how to grow this for the next decade," she says. But Lyne also argues that for right now, Martha is key to the brand and calls her imminent release "transformational" in getting the company back on course.

Other than being herself, it's not clear what Stewart's role will be once she finishes her five months of house arrest. Her title has yet to be decided, though she remains MSO's single largest shareholder, with more than 29 million shares. With that kind of clout, it almost doesn't matter what her title is—her voice will carry a lot of weight. Obviously, that could make Lyne's job a whole lot more difficult. Lyne needs to position the company to evoke a lifestyle and sense of taste, much as Ralph Lauren has done with his Polo brand. Doing that while MSO's namesake rushes back into the public spotlight and company meetings will be no easy task.

Still, veteran staffers appear thrilled to have her back, even if she's not in an executive role. Insiders speak of a new sense of excitement after years of being in the doldrums. In the March issue of *Martha Stewart Living*, Editor-in-Chief Margaret Roach regaled readers with tales of Stewart "foraging for wild greens" on prison property and ordering her seeds for the spring. Roach says Stewart will return to the magazine with a column in the April

issue. Koppelman insists the brand is more than Martha—but he concedes that she remains the public's arbiter of taste.

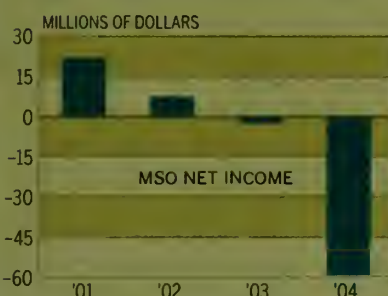
Stewart, not her company, is also the main attraction for NBC Universal Inc., which produces *The Apprentice*. "I don't think her popularity is in any way diminished," says Chairman and CEO Robert C. Wright. While it's no sure thing that her prime-time show will be a hit—the third season of Trump's version is getting mixed ratings—Wright feels no com-

SWEET AND SOUR

Excitement builds as Martha's release nears...



...but can she lift the bottom line?



Data: Bloomberg Financial Markets

punction about promoting her after the prison stint. "We're not here saying that she got a raw deal," says Wright. "She's paid her dues." Lyne compares the saga of Stewart's rise, fall, and redemption to classic dramatic structure: "Americans are waiting for the second act. They want to see a happy ending."

At the moment, events do point to a happy ending for Stewart. She's the rare convicted felon who will emerge from prison far richer than when she went in. She will personally get \$100,000 per episode for *The Apprentice*. And her stake in MSO has almost quadrupled in value, to nearly \$1 billion since last May. Investors can only hope they do as well. ■

—By Diane Brady in New York

BusinessWeek online For a Q&A with MSO Chief Executive Susan Lyne, go to www.businessweek.com/extras

EDUCATION

NO LONGER MOST LIKELY TO SUCCEED

Larry Summers' bold reform plan for Harvard could be derailed

SINCE HE BECAME PRESIDENT of Harvard University in 2001, Lawrence H. Summers has laid out an extraordinarily ambitious agenda for reshaping the nation's premier university. His goals include a long-overdue improvement in the education of undergraduates, increasing the role Harvard plays in science and engineering, and a huge expansion of the campus into Allston, across the Charles River from Harvard Yard. It's exactly the kind of daring vision the Harvard Corporation was expecting when it chose Summers.

But with Summers enmeshed in a highly publicized battle with Harvard's powerful Faculty of Arts & Sciences (FAS), that agenda could be derailed or slowed. Few expect Summers to lose his job over the fracas, which was sparked in January when he made his now-infamous comments that gender differences could help explain why fewer women than men excel in science and math. Corning Inc. CEO James R. Houghton, senior fellow of the Harvard Corp.—the only body that can fire Summers—strongly backs him. And while faculty members met on Feb. 22 to discuss Summers' performance, they did not hold a no-confidence vote—though that could still happen at a meeting set for mid-March. The same day, 186 professors signed an open letter supporting Summers. "I think he will survive," says Rita Bornstein, a leading expert on college management. But she warns that Summers is still in a critical testing period. "If you look at the sad story of presidents who fail," she says, "usually it is because they don't try to fit into the culture of the institution."

Pushing through reforms at Harvard would be difficult in the best of times. The president cannot simply order people



SUMMERS His remarks could turn off the scientists he needs to hire

Fight For Harvard

The Summers storm threatens badly needed changes at the university

UNDERGRAD EDUCATION Summers aims to modernize Harvard College. But his conflict with the Faculty of Arts & Sciences, which must approve any changes, has put him on the defensive.

CAMPUS EXPANSION He may be forced to consult more fully with professors about plans to move departments or schools across the river from Cambridge, potentially slowing down the process.

FUND-RAISING Over the next few years, Harvard hopes to raise an estimated \$5 billion to help pay for the reforms. But prolonged turmoil could cause some donors to sit on their wallets.

around. He must build consensus with a constellation of powerful deans and their faculties. Yet there is broad support for quite a few reforms Summers has set in motion, and many faculty members believe Harvard must change if it is to remain a leading university. But Summers' critics say he has needlessly antagonized

professors with his autocratic style. And he has alienated many by passing over internal candidates and giving tenure to outside stars. "He has mishandled the faculty," says a professor who backs Summers. "And very few people like him."

Turning that reputation around will be crucial if Summers is to remake the undergraduate program. He wants to modify the curriculum, increase foreign studies, and hire as many as 140 additional professors, roughly a 20% increase. On his credit, Summers has faculty committees looking into these reforms. But many of the changes will have to be approved by the now-divided FAS. "The danger is that faculty will dig in

heels," warns an influential Harvard professor.

Similarly, to bolster the sciences and technology, Summers is talking about launching an engineering school while expanding initiatives in the biosciences and other cutting-edge fields. But his remarks about women may make it hard for Harvard to recruit top female scientists, especially if it is seen as a more hostile environment than other universities. Summers will have to live up to recent pledges to greatly increase efforts to hire more women scientists.

The Summers controversy could even harm fund-raising. With a \$22.6 billion endowment, Harvard has long been the envy of higher education. Now it's planning to raise an estimated \$5 billion over the next few years to help pay for Summers' plans. The last thing it needs is an image problem. "Perceptions matter in fund-raising," says Scott C. Nichols, associate dean of Harvard Law School.

"Money is attracted by strength."

Summers may survive this dust-up, but backers and detractors alike say he'll have to adopt a more collegial style in a hurry. Otherwise, much of his vision for Harvard could die on the drawing board. ■

—By William C. Symonds in Boston
with Aaron Bernstein in Washington

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HEADLINER STEVE JOBS



AN IPOD A DAY...

For years, Apple Computer Chief Executive Steve Jobs endured endless complaints about Apple's fast-falling market share in the PC business. But now that he's king of the hill in the digital-music market, Jobs seems intent on grabbing share with a vengeance.

With Apple's iPod family already in control of 55% of this fast-growing market, Jobs on Feb. 23 unveiled new lower-priced models. The company reduced the price of its existing 4-gigabyte iPod mini by \$50, to \$200, to make room for a new 6-GB model costing \$250. And to goose sales of the poorly selling iPod photo, it dropped the price of that model to as little as \$350, from \$600.

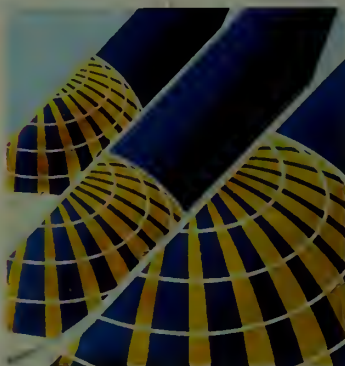
"They're basically competing at every price point now. We think they've locked out the competition for at least the next six months," says Piper Jaffray analyst Gene Munster. Jobs couldn't be reached for comment but in the past has said, "It's nice to see what we can do without that 5% market share ceiling." But not so nice for Apple's e-music rivals.

— Peter Burrows

HOME DEPOT GETS NAILED

Home improvement took a bit of a hammering. On Feb. 22, Home Depot posted a heady 9.5% rise in fourth-quarter profits, to \$1.04 billion. But its stock fell 4.1%, to \$40.28, amid concerns that the nation's largest do-it-yourself chain failed to deliver another forecast-topping quarter. Analysts' fears about store saturation also grew as Home Depot reported lower traffic in its more than 1,800 outlets. To boost growth, it plans to push deeper into international markets and installation services. Fast-growing rival Lowe's, meanwhile, showed a 27% jump in quarterly profits, to \$508 million, buoyed by better-than-expected sales growth and a bevy of new outlets in big markets. But Lowe's stock was flat on Feb. 23 after execs issued more cautious growth projections for 2005. The home improvement sector, it seems, still has work to do.

NEW PACIFIC OVERTURES



In a rare bit of good news for airlines, Continental and American won tentative approval from the U.S. Transportation Dept. to begin service to China. With passenger traffic and fares

growing briskly in the Pacific, the routes should be lucrative, says Calyon Securities analyst Ray Neidl. Continental will begin flying daily from its Newark hub to Beijing later this year, while American will offer flights to Shanghai from Chicago's O'Hare International Airport beginning in 2006. It beat out rival Delta Airlines, which wanted to serve China from its hub in Atlanta.

GM'S STICKER SHOCKER

If you can't beat 'em ... cut your price. Pressured by stiff competition in the sport-utility market, especially from the Japanese, General Motors has quietly sliced sticker prices on its midsize SUVs by as much as \$2,000. And those vehicles still carry \$2,000 rebates. It's unusual for an auto maker to drop prices significantly in the middle of a model year. Why is GM worried? U.S. sales of midsize SUVs fell 21% in January, while sales of GM's Chevy TrailBlazer and GMC Envoy plunged 42% and 48%, respectively. The prolonged price war is forcing rival carmakers to offer more creative come-ons. Ford Motor is currently offering a free Dell desktop PC to buyers of a 2005 Focus compact—and that's on top of 0% financing or \$2,000 in cash.

FRESH WOES FOR FANNIE

Are more shoes about to drop at Fannie Mae? The mortgage-housing giant said on Feb. 23 that its regulator had identified new problems with its accounting practices in five areas, including deficiencies in loan and securities transactions, and in

consolidations. Fannie also said that the Office of Federal Housing Enterprise Oversight had approved and extended the deadline for its plan to boost capital reserves by 30% above the minimum required. Fannie now has until Sept. 30 to increase its capital levels; previously, it only had until June.

ET CETERA...

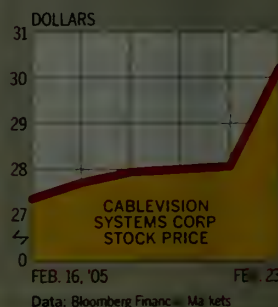
» Chiquita Brands will pay \$855 million for Performance Food Group's Fresh Express salad business.

» Boeing should reap about \$1.6 billion from two long-awaited asset sales.

» Winn-Dixie Stores filed for Chapter 11 bankruptcy court protection.

CLOSING BELL

Cablevision Systems shares rose 8%, to \$30.30, on Feb. 23 amid expectations the father-son team of Charles and James Dolan may sell the nation's fifth-largest cable operator; the Dolans won't comment. The company also is bullish about 2005 cable revenues.



Data: Bloomberg Finance Markets

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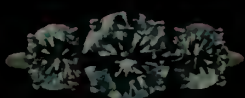


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EDITED BY RICHARD S. DUNHAM

Trial Lawyers Will Take Their Case to the People

BUSINESS LOBBYISTS WERE a joyous bunch on Feb. 18. With a grand East Room ceremony, President Bush signed into law the Class Action Fairness Act, the most significant piece of tort reform in a generation. But one man's rapture is another man's gloom, and a couple of miles away at the Association of Trial Lawyers of

America (ATLA), CEO Jon Haber was marking his first week on the job with an enormous legislative setback for the mighty tort bar.

Haber has a simple mission: Make sure that the class-action defeat is an aberration instead of just the first blow in a victorious Bush crusade against what Republicans portray as an out-of-control system of legal redress. To do that, Haber will have to transform ATLA from a behind-the-scenes player that derives much of its power from campaign donations into a grassroots outfit in which kinder, gentler lawyers deliver a populist message directly to voters.

'Loony' Lawsuits

HABER, A 51-YEAR-OLD public-relations executive and veteran Democratic political operative, has his work cut out for him. Bush has spent the past four years demonizing trial lawyers, blaming "junk lawsuits" for everything from lost jobs to high health-care costs. A well-funded campaign by the business-backed American Tort Reform Assn. has skewered lawyers as elitist vultures and highlighted "judicial hellholes" across the country that it says welcome "loony" suits.

Such vitriol strikes a raw nerve with trial lawyers, but the pain was bearable as long as ATLA was winning on Capitol Hill. Now class-action reform effectively moves large lawsuits out of the states and into federal courts, where business believes it can win fairer hearings. And the White House has even more ambitious goals. Next up: curbing medical malpractice claims and limiting awards that exceed victims' costs.

So how will the new ATLA boss change the dynamic? For one thing, he'll use PR skills honed representing America Online, Yahoo!, and TechNet to appeal to blue-collar swing voters. "I don't agree [that business interests] have traction with Joe Sixpack," Haber says. "Average Americans don't want a system that's tilted so it works for the rich and powerful." But even with a lobbying budget of over \$5 million last year, turning trial lawyers into plain folk may take some doing. "When they walk in with their \$5,000 suits and gold cufflinks, they don't look like the downtrodden," says Tort Reform Assn. General Counsel Victor E. Schwartz.

Haber's approach acknowledges a new political reality: The plaintiff's bar can't keep tort reform at bay simply by writing campaign checks. Trial attorneys, who doled out \$2.6 million to candidates in 2004 through ATLA's political action committee and millions more through their own firms, for the first time find themselves outspent and outmaneuvered by business. Says leading plaintiff's lawyer John P. Coale: "Right now we can hold the votes we need in the Senate for really important stuff, but that's getting whittled away."

That's why Haber wants to fight Corporate America and its White House allies for the hearts and minds of Middle America. The new legal lobbyist-in-chief dresses like an average Joe, shunning neckties and power suits. And much like its new leader, ATLA is shedding the gold cufflinks as it laces up the boxing gloves. Trouble is, at this point in the match, most of the crowd is cheering for the other side. ■

—By Lorraine Woellert



BUSH Signing tort reform into law

CAPITAL WRAPUP

NO CORN, NO WHEAT, NO TREASURY NOMINEES

RANKING SENATE Finance Committee Democrat **Max Baucus** is hitting the understaffed Treasury Dept. where it hurts—in the executive suite. The Montana senator, joined by Committee Chairman **Chuck Grassley** (R-Iowa), is unhappy with tighter restrictions recently announced by Treasury on the financing of food exports to Cuba. Treasury now says cash payments (sorry, no credit allowed) must be made before shipment, not afterward, as was the case previously. Grassley says he can't "see any legitimate reason" for the new rule, which will hurt Iowa corn farmers by making the transactions even more complicated. Baucus, a big backer of wheat growers, says he will block Treasury nominees from Senate confirmation. So for now, Treasury may have to make do without a deputy secretary and two under secretaries.

THE PUBLIC TO RICE: YOU'RE NO POWELL

CONDOLEEZZA RICE may have gotten rave reviews from the cognoscenti on both sides of the Pond after her first trip to Europe as Secretary of State, but most Americans are far less impressed. A Feb. 8-13 Harris Poll found that 52% of the public had a favorable view of Rice, while 40% had a negative impression. Former Secretary of State **Colin Powell**, consistently the most popular member of **President Bush's** Cabinet, departed from Foggy Bottom with a 66% approval rating. But Rice can take consolation in the fact that she is viewed more favorably than Bush (48%), Vice-President **Dick Cheney** (45%), and Defense Secretary **Donald Rumsfeld** (42%).

THE ECONOMY

EVERY LITTLE REFORM COUNTS

A slew of modest measures in Germany and France may add up to brighter growth prospects for 2005

A FUNNY THING HAPPENED in Europe on Feb. 15. As businesspeople from London to Lisbon were settling down to work, they were hit with some of the most unsettling economic news in months. New data suddenly showed that the German and Italian economies had actually shrunk in the last quarter of 2004, despite near-unanimous predictions of mild growth. That shocker came just days after German jobless rolls sailed past the 5 million mark for the first time since World War II ended. So how did the markets react? The euro strengthened. And euro-zone shares shot up.

Are European investors crazy? Not really. The very day that scary news was spreading, one of Germany's most respected economic institutes was broadcasting a story of a different sort. Up in Mannheim, the Center for European Eco-

nomics Research, which conducts a monthly survey of the expectations of professional economic analysts, reported a 33% increase in confidence about the German economy. True, enthusiasm sagged a bit when, a week later, the Munich Ifo Institute's closely watched index of German business confidence dipped in February after two consecutive months of improvement. But economists say confidence is still good. "The [absolute] level of the Ifo index is very solid," says David Millkeker, head of industrial countries research at Dresdner Bank in Frankfurt.

The indicators may not all be marching forward in lockstep. But on balance, the numbers appear to be telling a positive story. Even the unexpected 0.2% dip in Germany's fourth-quarter output was driven largely by reduced public spending—manufacturing and consumer spending remain on an upward trend. Nuremberg-based market researcher GfK's consumer confidence index for

Germany rose to 4.1 in February, from January's 3.1.

Indeed, some suggest that the Continent could be at a psychological tipping point at which both consumers and business are feeling cautiously optimistic. That's the sort of lift Europe's slow-growth economy could sure use. "The leading indicators have been rising for several months," says Holger Fahringer, senior economist at UBS in Frankfurt. "That is leading people to look slightly more optimistically into the future."

TWEAKING

IF THIS IS THE CASE, it's not because any big-stroke, courageous policy move. Rather, it may be that the cumulative weight of small reforms in France and Germany is beginning to add up to something. These range from laws to free up rigid labor markets to tax incentives designed to attract investment. "There is suddenly a different story," says Joachim Fels, economist at Morgan Stanley in London.

Take Germany. Economically speaking, the second half of 2004 was a write-off. Hard-hit German consumers were spooked by crises at retail giant KarstadtQuelle and construction giant Walter Bau. Deutsche Bank, once the bedrock of the country's rock-solid economy, geared up for massive job cuts. Most of all, Germans were worried that Chancellor Gerhard Schröder's labor market reforms would lead to massive layoffs.

Yet when the reforms actually took effect in early January, their impact was much less severe than many had feared. Unemployment in January hit a postwar high of 12.1%, according to non-seasonally adjusted figures. But that figure was

More Than Meets The Eye

Some of the incremental reforms that, taken together, are driving up business confidence and leading indicators:

GERMANY

- Pared back long-term unemployment benefits, and put more pressure on jobless to find work
- Cut corporate and personal income taxes
- Reformed bankruptcy law to encourage risk-taking
- Cutting red tape at local government level
- More public and private support for startups
- Labor unions more flexible on hours, pay

FRANCE

- Relaxed 35-hour workweek, allowing employees to work up to 40 hours for extra pay
- Rolled back generous pensions for some public-sector workers
- Plans cuts in corporate and personal income taxes
- Simplifying procedures to lay off workers
- Introduced fiscal incentives to create low-paid service-sector jobs

Data: BusinessWeek



driven largely by changes in the methodology, and masked a positive trend: For the first time since 2001, the number of employed Germans has been rising. Presdner Bank calculates some 300,000 new jobs were created last year.

It's roughly the same story in France. The center-right government of Jean-Pierre Raffarin has been quietly but steadily moving to roll back measures once considered sacrosanct. Under legislation approved in early February, France's 35-hour workweek will be largely dismantled, with most workers getting green light to work longer hours.

Paris also is finally adopting measures to make France a more attractive to multinational companies. Until recently, factors such as the sky-high 48.9% marginal tax rate discouraged foreign companies

from setting up regional headquarters in France. Japan's Toyota Motor Corp. built a major plant in northern France in the late 1990s but still bases its senior Japanese executives in Belgium to shield them from French taxes.

To fight the trend, Raffarin has unleashed a host of small measures. Effective this year, non-French executives based in France will be exempt from paying tax on income not earned in France. At the same time, the government has been pushing local authorities to simplify the procedures non-European Union citizens need to go through to be able to work in France. Currently, it can take up to four months—and thousands of euros in fees—to secure working papers for a non-EU graduate of the prestigious

PARIS TRAM France's 35-hour workweek is being dismantled

French management school Insead. "The system in France is still an absolute nightmare," says Claire Lecoq, Insead's director of MBA career services. Because of French policies, she says, a vast majority of the school's U.S. and Asian graduates head to Britain, where they can get working papers in as little as four days.

SETTING THE STAGE

IN FRANCE, as in Germany, the reforms may be starting to gain traction just as companies are beginning see benefits from several years of tough restructuring. Buoyant exports, payroll slashing, and offshoring of jobs to cheaper locales in Eastern Europe—coupled with increasingly sophisticated capital markets—are helping pave the way for fatter profits. Although not all companies have reported 2004 results, the data thus far show that the net profits of France's top 40 blue-chip companies rose 30% last year, while the 30 companies that make up Germany's benchmark DAX stock index logged a 72% jump. "It is only this year that profits in the euro area are being restored in a way that sets the stage for expansion," says John Lipsky, chief economist of JPMorgan Chase & Co.

Lipsky believes that economic growth in Europe is set to tick upward to 2% a year. True, that's lackluster by global standards and not enough to make a dent in unemployment. But if psychology is in fact beginning to shift in Europe, it could well make it easier for gun-shy gov-

ernments to push through more meaningful reforms. Getting consumers to spend is key, and that means making it easier and cheaper to get credit. France and Germany, for example, make it almost impossible for homeowners to take out secondary mortgages. Considering that half of all household wealth in those nations is tied up in real estate, compared with just one-quarter in the U.S., there is a vast pool of resources that could be tapped. With steady-drip reforms, Europe may finally be wearing away some of the toughest obstacles to growth. ■

—By John Rossant in Paris and Jack Ewing in Frankfurt



MILAN STORE
Wind is ripe for an overhaul

MERGERS AND ACQUISITIONS

RED-CARPET TIME FOR AMERICANS

U.S. private equity firms are finding Europe the new land of opportunity

WIND, ITALY'S No. 3 telecom group, has always been a poor fit as part of Enel, the country's electricity giant. So last fall Enel began preparing to spin off Wind in an initial public offering. But these days nothing that's for sale in Europe escapes the roving gaze of the private equity dons. So on Feb. 15, U.S.-based Blackstone Group pounced. And the offer it made took Corporate Europe's breath away.

Blackstone proposes to do a leveraged buyout of Wind that would value it at \$16.6 billion. That would make the deal the second largest ever, behind the \$25 billion RJR Nabisco buyout in 1988. And Blackstone's huge offer—in which it is expected to put up \$2 billion and tap other investors and banks for the rest—isn't necessarily the only one. Other investors are poring over Wind's books and could sweeten the pot with rivals' bids.

Europe is suddenly the world's playground for private equity. Last year private equity funds invested \$156 billion in European companies, up 66% over 2000. More than half of Europe's merger-and-

acquisition deals in 2004 were financed by private equity groups. Among the most notable: Clayton, Dubilier & Rice Inc.'s \$4.5 billion buyout of French electrical equipment supplier Rexel and Blackstone's \$1.3 billion takeover of Holland's New Skies Satellites.

Driving change is Europe's struggle to get more competitive. Businesses, from small family enterprises to huge chunks of Europe Inc., are embracing private equity overhauls to ratchet up growth and earnings. "The U.S. is about 10 years ahead of Europe in its focus on corporate efficiency," says Nigel McConnell, managing director of London-based Electra Partners Europe.

INVASION

BLACKSTONE wouldn't comment on its bid for Wind, but it has been a major player on Europe's dealmaking scene since the mid-1990s. Last year roughly half its

global business was in Europe. It's alone. All the big U.S. players have p in, jostling for deals against local fur Rival Kohlberg Kravis Roberts & Co. up its London-based operations in 1 and last year snapped up five compar totaling \$9.8 billion, including MTU Engines, Dynamit Nobel, and Ro Vendex. Not to be outdone, the Car Group, which opened its first Europe outpost in 1997, is about to close a \$2.7 billion Europe fund.

Private equity is accelerating restructuring across the Continent and supporting a nascent shareholder culture at a time when most European stock markets are in an IPO-unfriendly funk and overcautious banks are unwilling to lend cash-strapped companies. "Ten years ago, German CEOs didn't think private equity could help them," recalls Henry Kravis, founder and partner at KKR. Times have changed.

Money-losing Wind is the perfect example of a company ripe for an overhaul. Analysts say there is ample opportunity to leverage its ambitious investments in one of Europe's only integrated fixed and wireless telecom networks just as a new market for broadband services takes off. "Wind can offer a quadruple play—merging voice, Internet, mobile, and video services" over one network, says Emilio Pucci, director of e-Media Institute, a search house based in Milan and London. By restructuring and offering management better incentives, Blackstone wants to make Wind a more nimble and profitable player with its next-generation technology. But Egypt's Orascom Telecom is rumored to be preparing to top Blackstone's bid in coming days.

How long can the dealmaking bonanza last? With ever-bigger funds chasing a limited number of deals, the risk is growing that bidding wars will start to undercut future returns, especially at the top end of the market. "If you're not disciplined, you can pay more than what's reasonable," says Benoît Colas. Paris-based managing director of the Carlyle Group. But for now, the private equity pipeline shows no sign of running dry. And that's good news for Europe Inc. ■

—By Gail Edmondson
Frankfurt, with Maureen Kline in Milan and Carl Matlack in Paris

Private Equity Push

The number and value of private equity M&A deals in Europe is rising fast

YEAR	DEAL VALUE
2000	\$93.9 billion
2001	87.3 billion
2002	118.3 billion
2003	127.0 billion
2004	156.3 billion

Data: Dealogic



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CHINA

A GLOBAL TELECOM TITAN CALLED...ZTE?

China's No. 2 cellular-gear maker aims to join the ranks of Nokia and Motorola

THE AMBITION OF JUST about everybody in the telecom world is to make phones that are smaller, faster, and more capable. So the industry has grown accustomed to announcements of groundbreaking handsets from the likes of Motorola, Nokia, and Samsung. But at the art deco Majestic Hotel in the French city of Cannes on Feb. 14, those stalwarts weren't the ones wowing the crowds with the world's tiniest 3G cell phone, featuring video calling and other multimedia functions. Instead, it was a Chinese challenger, ZTE Corp.

ZT-who? Based just north of Hong Kong in Shenzhen, ZTE is little known in the West. But it's China's second-biggest telecom equipment vendor, after crosstown rival Huawei Technologies Co. Sales of its handsets, base stations, switches, software, and broadband networking gear grew 35%, to \$4.1 billion, last year. Profits jumped 50%, to an estimated \$186 million, according to brokerage DBS Vickers Securities. And exports soared 170%, to \$1.6 billion. Now, ZTE President Yin Yimin says he wants overseas sales to account for more than half of revenues as soon as next year. While Nokia, Samsung, and Motorola have bigger brand names, "we don't think we're inferior to them," Yin says. "We don't think there's a big difference."

ZTE is now letting the world know. The Cannes presentation, for the annual 3GSM World Congress trade show, kicked off a five-month campaign to court telecom operators from Portugal to Turkey. Even better, ZTE used the conference to unveil a deal that may prove far more important than the 104-gram handset introduced that day: a partnership to supply French giant Alcatel with base stations for cellular networks using the CDMA stan-



ZTE: China's Other Telecom Giant

HEADQUARTERS Shenzhen

FOUNDED 1985

LISTINGS Shenzhen in 1997; H-shares, open to foreigners, in Hong Kong in 2004

MARKET CAP \$3.3 billion

2004 SALES \$4.1 billion (up 35% over 2003)

2004 PROFITS \$186 million*

MAIN PRODUCTS Cellular infrastructure, mobile phones

RESEARCH LABS 11—in China, Sweden, Korea, and the U.S.

OVERSEAS CUSTOMERS Mostly telcos in Asia and Africa, though ZTE is becoming more aggressive in the West

Time

Data: ZTE DBS Vickers

dard. "ZTE has proven technology expertise in CDMA radio, so we're pleased that the two companies will work together," says Marc Rouanne, chief of Alcatel's mobile communications unit.

Despite its relatively low profile, ZTE is no upstart. It has been publicly listed in Shenzhen since 1997, and in December raised \$400 million by also offering shares in Hong Kong, where foreigners can buy them. The company was founded in 1985 by a handful of state-owned companies affiliated with the Ministry of Aerospace Industry and has grown along with China's big phone companies, which are ZTE's top customers. ZTE also has had success abroad, largely with operators in countries in Asia and Africa. Yin says the company is able to prevail over bigger competitors in such markets because its home base in China gives it a better understanding of how to operate in developing countries. To really grow, though, Yin knows he must transfer the success to more developed markets. ZTE plans to use the proceeds of the Hong Kong listing to expand its international sales network, establish production overseas, and beef up its research spending.

COMPETITION AT HOME

ZTE FACES SOME major challenges. Building the ZTE brand from scratch in Europe will take time and piles of cash. In China the company has done well selling handsets and equipment based on PHN low-end cellular-like technology that is now becoming obsolete as operators focus on more-advanced 2.5G and 3G services. PHN accounted for 27% of revenues last year but is likely to drop to just 11% in 2005, according to Deutsche Bank research. And ZTE's CDMA handset business may be threatened as the Chinese government loosens restrictions on the number of companies allowed to make phones. Last year three dozen players made 240 million handsets, but some experts say production could double this year as dozens more companies jump in—which could take a big bite out of ZTE's profits.

Given that sort of competition at home, it's no wonder that Yin vows to push beyond China's borders. Expanding overseas "is not just a development issue," he says. "It's a survival issue." ZTE may not be the biggest player in China or even in its hometown. But clearly, this newcomer on the international scene won't be content to play second fiddle for long. ■

—By Bruce Einhorn in Shenzhen with Andy Reinhardt in Cannes

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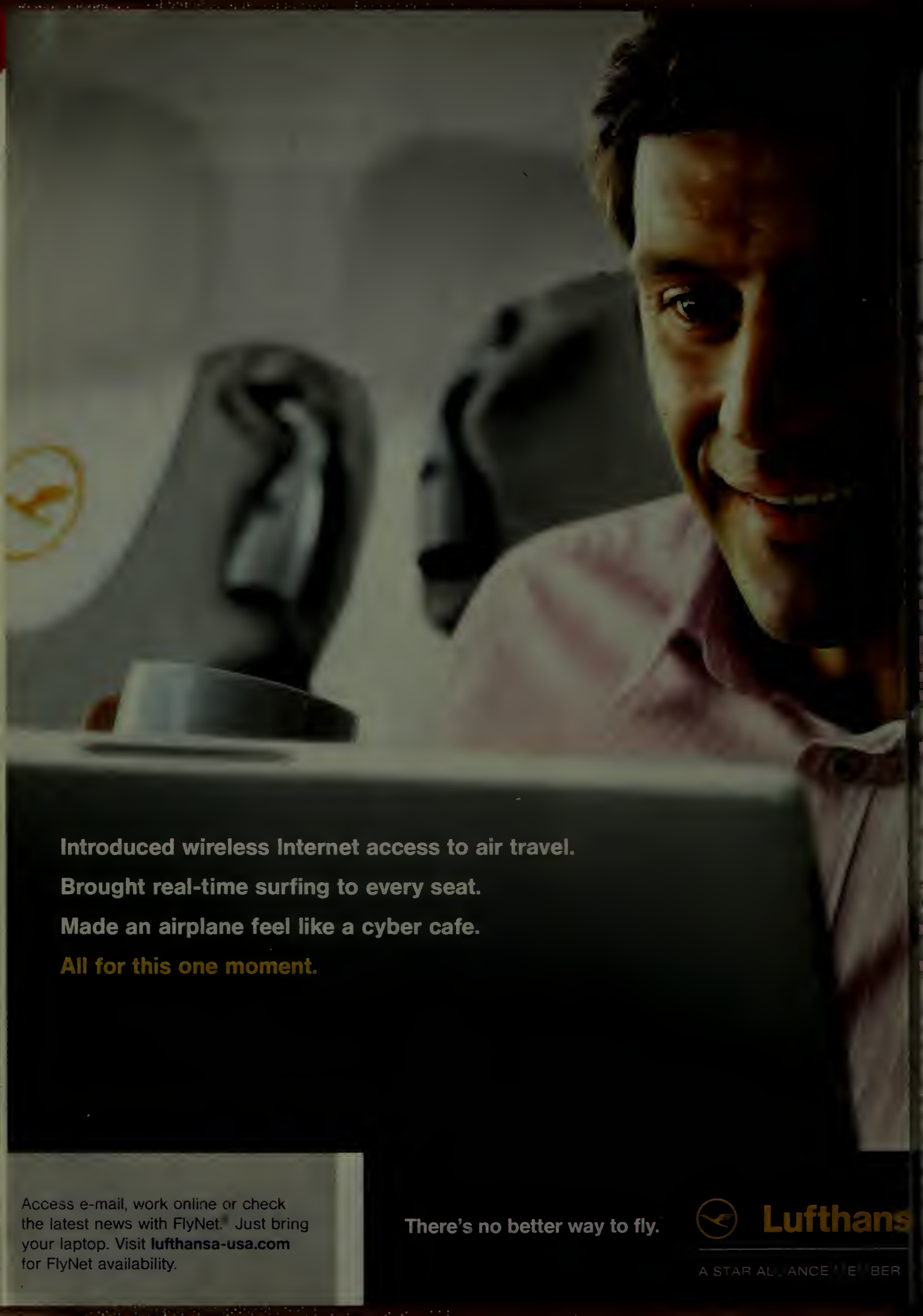
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A STAR ALLIANCE MEMBER

EDITED BY ROSE BRADY

The Sands Are Shifting Under Egypt's Mubarak

THOUSANDS OF PEOPLE filled the streets of Beirut on Feb. 21 to protest Syria's occupation of Lebanon and the recent assassination of former Lebanese Prime Minister Rafik Hariri. On the same day, a few hundred protesters gathered in Cairo to call for an end to the rule of Egyptian President Hosni Mubarak, who has been in power for 24 years.

The rising tensions arrive at a time when the Bush Administration's Middle East activism is moving into a tricky phase. In the wake of Iraq's election, the U.S. is determined to push for more democracy in the region. Hariri's assassination provides an opportunity for the U.S. to ratchet up the pressure on Syria to give up control of Lebanon. Syrian President Bashar al-Assad is likely to wind up with a choice of yielding to the U.S. or facing tough sanctions.

"Bashar is about to be taught a life lesson," says a Western diplomat.

Touchy Situation

SPARRING WITH the likes of the recalcitrant Syrians entails only modest risks for the U.S. Nudging Egypt, long an American ally, along the road to greater democracy is tougher. If the U.S. doesn't call attention to the lack of freedom in Egypt, it will look hypocritical. Yet just about any U.S. effort to influence Egypt's political direction will spark charges of meddling from old guard elements around Mubarak. If the Bush Administration is too blunt, it may lose Egypt's support on key diplomatic goals.

Recent events have underscored the touchiness of the situation. Mubarak drew unwelcome notice from Washington when he had Ayman Nour, leader of a new political party called Al-Ghad, or Tomorrow, jailed on Jan. 28. The government says the party filed forged signatures when it officially registered. But observers suspect that Mubarak's advisers feared the youthful Nour could become a U.S.-backed candidate to replace the 76-year-old President.

Such fears increased when Foreign Minister Ahmed Aboul Gheit was peppered with questions about Nour on a recent U.S. visit. Particularly galling to the Egyptians was Secretary of State Condoleezza Rice's comment that she had raised "our very strong concerns" about the Nour case. The Egyptians then showed their anger by postponing a G-8 meeting on Arab reform that was scheduled for March in Cairo.

These squabbles are happening against the backdrop of a region ripe for change.

People are fed up with regimes that are repressive and have failed to deliver prosperity. In Cairo, protests are being organized by a movement called Kefaya, or Enough, to demand that Mubarak not run for a new six-year term. Protesters often carry signs saying "no to inheritance"—a reference to



RIISING TENSION
Demonstrating against Mubarak in Cairo

the possibility that Mubarak's son, Gamal, could succeed him. "For the first time, people are talking about free and fair elections," says Mona Makram Ebeid, secretary general of the Tomorrow party.

Mubarak has long summoned the specter of a fundamentalist takeover in the Arab world's most populous state to justify his extended stay in power. Critics, however, want the constitution rewritten so that the President is directly elected, rather than nominated by Parliament and approved by referendum, as is now the case. Mubarak will probably run anyway—and be selected. But parliamentary elections will follow, and they are likely to be hotly contested. Like the Lebanese, Egyptians can smell the end of an era. ■

—By Stanley Reed in Cairo

GLOBAL WRAPUP

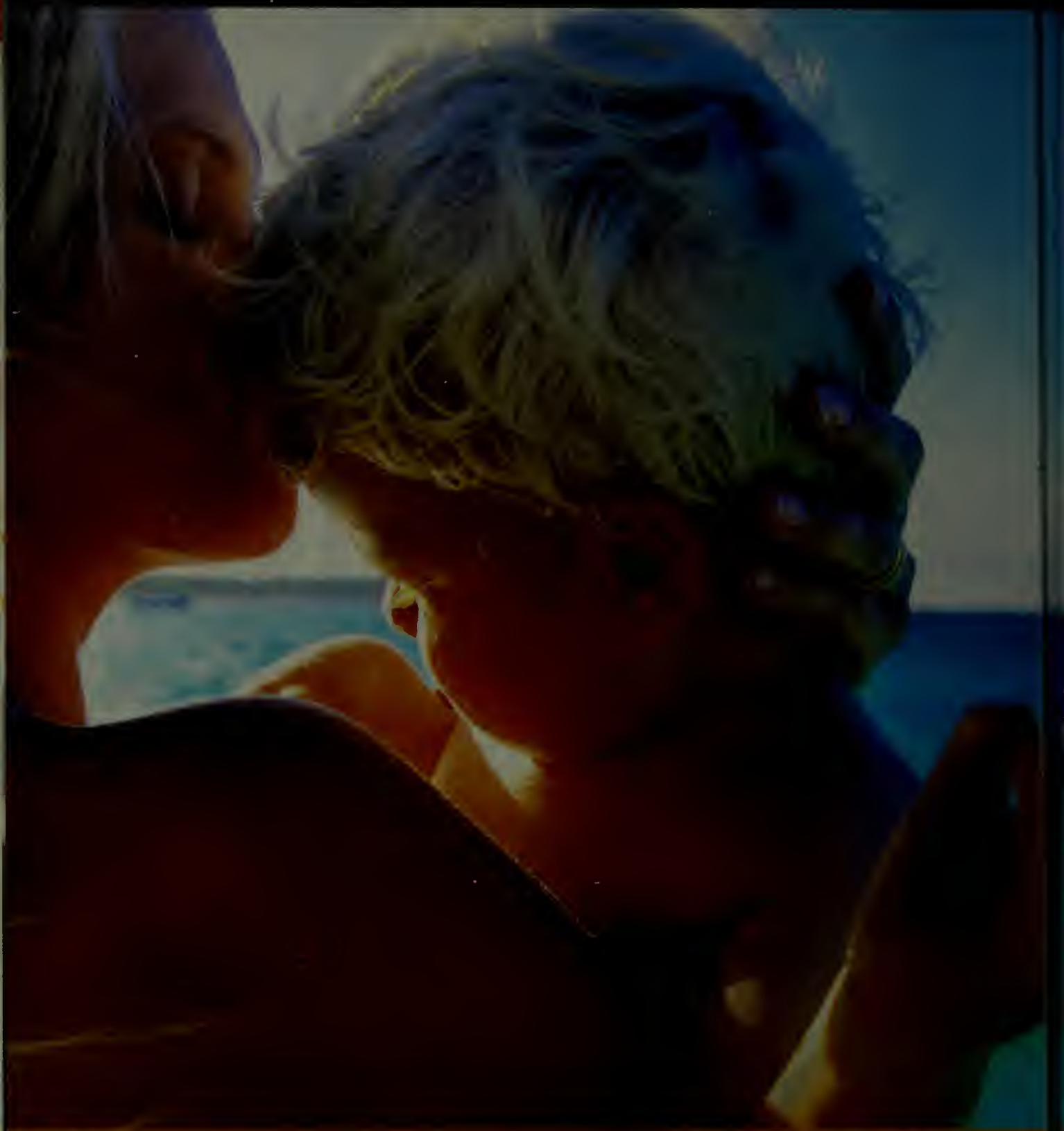
A BANNER YEAR FOR ISRAELI ARMS EXPORTS

ISRAEL'S BUDDING defense relationship with India continues to expand. In 2004, New Delhi became the Israeli defense industry's largest customer, accounting for nearly half the country's \$3.6 billion in arms exports, its second-best year ever. The largest item was India's purchase of Phalcon early warning planes from **Israel Aircraft Industries**. Israel is one of the world's top five arms exporters, accounting for 10% of the global arms trade. And India-Israel relations have been warming. The two countries plan joint military exercises later this year.

DUBLIN AND LONDON STEP UP PRESSURE

BOTH THE British and Irish governments are making moves to marginalize **Sinn Fein**, the political party linked to the Irish Republican Army, unless it helps break the deadlock in the Northern Ireland peace process. On Feb. 22 the British government threatened to cut parliamentary allowances for four elected Sinn Fein deputies, which would strip nearly \$1 million from the party's coffers. The threat followed allegations that the IRA carried out a \$50 million heist of a Belfast bank in December.

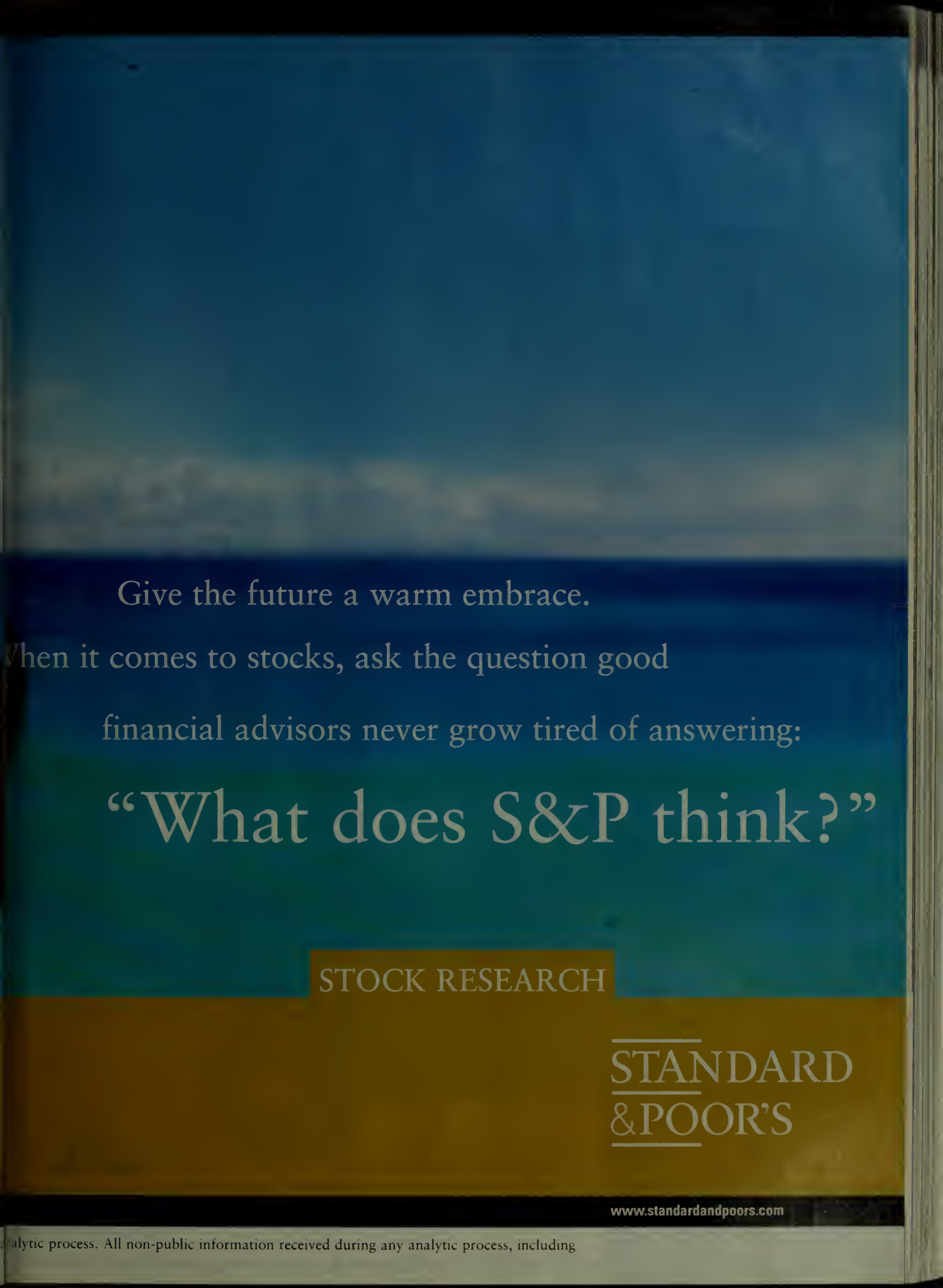
Days earlier, Ireland's Justice Minister, **Michael McDowell**, took the unprecedented step of publicly naming three of Sinn Fein's top figures, including party leader **Gerry Adams**, as members of the IRA Army Council, a charge they deny. London and Dublin want Sinn Fein to force the IRA to finish disarming, as agreed in the Good Friday peace accord of 1998. Only then can a new power-sharing government in Belfast be formed.



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AFL-CIO CRITIC Hotel workers' union leader Wilhelm thinks labor needs a big overhaul

Big Labor's Day of Reckoning

As a critical confab nears, how far is the AFL-CIO willing to go to stem its decline?

WHAT IF YOU turned on the tube and saw a labor-run news and entertainment network with shows extolling the benefits of labor unions? Or scores of sit-down strikes erupting around the country in a national campaign to form new unions at Wal-Mart or McDonald's?

These are just two of the ideas unions have tossed out in recent weeks in an extraordinary internal debate that is gripping the U.S. labor movement. The soul-searching was kicked off last autumn by Andrew L. Stern, president of the Service Employees International Union (SEIU). He challenged his fellow union chiefs to take drastic measures to reverse labor's decades-long decline.

Stern's prodding, coming from the nation's largest and fastest-growing union, provoked a wide-ranging discussion un-

like any the labor movement has engaged in since the AFL-CIO was founded 50 years ago.

FLAGGING CLOUD

THE OUTPOURING OF proposals from dozens of labor groups will be on the table when the AFL-CIO's governing Executive Council gathers on Mar. 1 in Las Vegas for its annual winter meeting. While union leaders say they may not reach a full agreement by then, most think a broad consensus is emerging about major changes labor should undertake to try to boost its

flagging clout and membership. Among the most likely: significantly scaling back the AFL-CIO's staff and budget; boosting its already powerful political efforts; and slashing the unwieldy 54-member Executive Council (table, page 66). "There will be substantive changes," predicts Gerald W. McEntee, president of the 1.4-million member American Federation of



"THE FRENCH MAY BE EXPERTS ON FOOD AND WINE, BUT WHAT CAN THEY TEACH US ABOUT RUNNING A COMPANY?"

Armando Zagalo de Lima of Xerox appreciates the French taste for innovative management as much as he enjoys their taste for the good life.

Workplace Unions

State, County & Municipal Employees.

One wild card is whether anyone will announce a challenge to President John J. Sweeney, 70, who'll be up for reelection at the AFL-CIO's quadrennial convention in July. For months labor leaders have been expecting Stern ally John W. Wilhelm, the No. 2 official at UNITE HERE, the needle-trades and hotel workers' union, to announce his candidacy at the Las Vegas meeting. But he hasn't yet gathered enough votes, say leaders on both sides, so he may decide not to provoke an open fight. "The next question is the leadership question," says Wilhelm.

Whatever he decides, the labor movement's basic structure will be hotly debated in Las Vegas. Sweeney came to office in 1995 vowing to focus shrinking unions on membership growth. His push ignited widespread enthusiasm in the movement for several years, but that energy faded as the effort produced disappointing results at many unions. While few unionists blamed Sweeney for their own failures, Stern, Wilhelm, and others insist he hasn't banged the table hard enough for reform. They and some other



union presidents—including even Sweeney supporters such as McEntee—also complain that Sweeney has built up a 500-plus-person bureaucracy at the AFL-CIO that isn't aggressive enough in reversing labor's decline.

CREATIVE IDEAS

MATTERS CAME TO a head in November when Stern issued a set of proposals to radically overhaul the AFL-CIO and its member unions. Sweeney struck back by calling on all unions to put forth ideas to be considered at the Vegas gathering. Delegates to the AFL-CIO's convention in July will then vote on any changes to its constitution.

In recent months many unions have held formal reviews of labor's problems and submitted some surprisingly creative ideas for solving them. The American Federation of Teachers, hardly a bastion of take-to-the-streets unionism, suggested that labor form startup unions from scratch that would have few assets. The reasoning: With little to lose, they would be bolder about using such illegal recruitment tactics as secondary boycotts or sit-down strikes. The Laborers Union, whose president, Terence M. O'Sullivan, is also the CEO of ULLICO Inc., a union-owned insurer, argues that labor should consolidate all its financial purchases and investments into a multibillion-dollar powerhouse. The goal would be to create a union-owned profit center that could earn money and amass financial clout by cutting out the legions of Wall

ON THE DEFENSIVE

Sweeney has failed to spur membership growth

Street insurance, credit card, mortgage, and pension-fund providers not used by unions.

The most sensitive to is likely to be the nature of the AFL-CIO. To highlight its unhappiness with Sweeney's tenure, the Stern camp is pushing a proposal to allow unions to keep half of the \$100 million in dues they collect

tively pay the federation each year as long as they spend the money to sign up new members in their core industries. Despite the blow it would represent to Sweeney, the idea has been endorsed by several large unions, including the Teamsters and United Food & Commercial Workers. Even Sweeney backer McEntee says he supports the concept, though he thinks the amount of the rebate should be more like 30% or 40%.

In an attempt to control the debate, Sweeney plans to put forth his own set of proposals in Las Vegas. AFL-CIO officials have also been trying to limit the scope of any cutbacks by arguing that large chunks of its budget should be exempt from the dues-rebate scheme. "A lot of people think it's a good time to look at everything we do and be clear about areas where there might be redundancies," says Denise Mitchell, Sweeney's public affairs assistant. "But only a handful want to see a smaller and weaker federation."

The broader question is what the AFL-CIO's purpose and role should be. Wilhelm says the federation should focus almost exclusively on politics and organizing support. Others say it should continue to address everything from legislation to international affairs. The debate harkens back to the AFL-CIO's founding in 1955, when then-American Federation of Labor President George Meany said labor's central body should engage in politics, and the Congress of Industrial Organizations' Walter P. Reuther insisted that it should stick to bargaining and organizing. Meany prevailed, winning the presidency of the merged groups.

Despite the far-reaching nature of the discussion, it's not clear how much change labor leaders will embrace. More to the point, it may be too late to reverse labor's shrinkage, no matter what the decision to do. ■

—By Aaron Bernstein in Washington

How to Rebuild The House of Labor?

Unions are offering up dozens of reform ideas for debate at the AFL-CIO's winter meeting, which starts on Mar. 1. Among them:

SHRINK THE FEDERATION by letting the AFL-CIO's 58 unions keep half of the \$90 million in annual dues they now pay

STREAMLINE the governing Executive Council to 15 or fewer union leaders, vs. 54 today

ADD "GOD AND COUNTRY" to bread-and-butter economic issues as part of labor's message

TARGET new-member recruitment in Presidential battleground states for more political leverage

OWN THE AIRWAVES by spending some \$200 million to set up a labor-run cable TV network

GUARANTEE all striking workers at least \$200 a week with a national fund

REVIVE old-time tactics such as sit-down strikes or secondary boycotts

Data: BusinessWeek

European CEO Armando Zagalo de Lima says Xerox can rely on the French for innovative business practices.

You're in charge of Xerox across Europe. How does France fit into the picture?

Xerox France has consistently been one of our best performance units. It's been that way for a very long time.

What's the secret behind that success?

Strong leadership. There's always a link between senior leadership and success. Over the past 15 years, at least four of Xerox's heads of Europe have been French. Our French company has produced a very strong group of executives. They've instituted some highly innovative management practices and they've been extremely successful with them.

What sort of new thinking has your French unit come up with?

To give you just one example, there's the concept of concessionaires. That's a French word, by the way. It means we have a third-party company selling only Xerox solutions in exclusivity. It's quite a familiar idea in the car industry, but it's very original in our business. When our French unit came up with the concept 25 years ago, the rest of the company was extremely skeptical. But the French proved it could work. All of a sudden we had a network of people fully focused on our products and these people were making money. It's now become a business model for Xerox all over the world.

Xerox in France

- Over 4000 employees
- Over 140 concessionaires and more than 300 distributors
- Grenoble research facility is one of the four main Xerox innovation centers around the world

structure. That's a rare combination. France is a place where wild ideas can actually become reality. The French have that capacity to dream up a vision, build a plan to achieve it, then execute it.

What are they like to deal with?

The French have been very responsive to past criticism and are much more willing to conduct business in English. Communication is increasingly easy. French executives are very open and enjoy working face to face. They like people to come and say: "If there's a problem, call me and I'll be here." And they're loyal.

How would you sum up the French?

Creative, very open to doing things differently, to going after a big idea and thinking 'out of the box'. But at the same time, they like to work within a



"France is a place where wild ideas can actually become reality. The French have that capacity to dream up a vision, build a plan to achieve it, then execute it."

Unless he's really disappointed, a French customer will stay committed to his supplier. I've always had the feeling I could rely on the French.

Everyone knows what Xerox means. What does France stand for?

It's one of the world's great cathedrals of good taste. You feel that across the board. It's art, it's fashion, it's design, it's food and wine. And it's business too. I've always felt close to the French. You go to a lot of countries and you say, "I could do business here, but I'm not sure I want to live here." You don't say that in France. France is a place where you can do business and still appreciate the good things in life.

There has never been a better time to invest in France. To find out what the new France can do for your business, visit www.thenewfrance.com

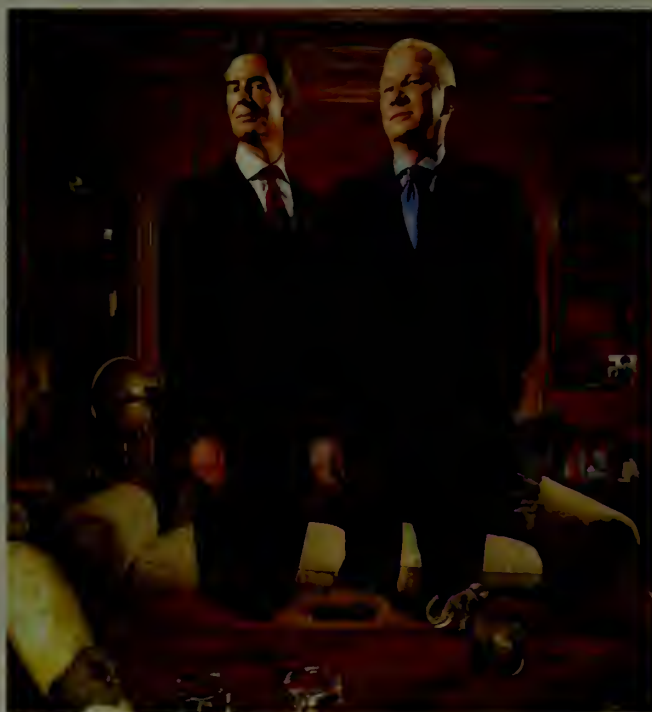
THE NEW FRANCE. WHERE THE SMART MONEY GOES.

Rescuing Tech's Orphans

Call it salvage capital. More private equity is flowing into struggling companies

IN 2003, TERRY GARNETT AND David Helfrich quit their jobs at established venture-capital firms to try their hands at building their own outfit. But they weren't looking to do traditional VC investments. Instead, they wanted to focus on what they saw as a growing opportunity: private equity buyouts of small tech companies. These deals, which range from \$20 million to \$100 million, fall into a little-served gap. The companies involved are neither the freshly minted startups that venture capitalists seek nor the established outfits that buyout specialists chase. "We felt we found a new niche that hasn't been addressed," says Garnett. "We said, 'Gosh, maybe there's a market for these small, orphan businesses.'"

No question, the opportunity is tantalizing. From 1997 through 2000, 6,832 companies raised a first round of venture capital, according to researcher VentureOne. A few bubble-era survivors still have potential but are idling under inept owners, stagnating inside big companies, or struggling with too little capital. "Because tech is maturing for the first time, the accumulated nonsense lying around that needs to be fixed is enormous," says Roger McNamee, a partner at Silver Lake Partners, which does large-cap tech buy-



outs. The opportunity: salvage capital. By fixing up these neglected outfits, Garnett & Helfrich Capital and other buyout firms plan to give these tech companies a new lease on life.

A few firms already do these deals. One of the oldest is Gores Technology Group LLC, a Los Angeles firm founded in 1987.

Another is Golden Gate Capital in San Francisco, founded in 2000 by former Bain Capital LLC partners.

Several salvage deals already have paid off. One is VeriFone Holdings Inc., a maker of credit-card readers. Once profitable and independent, VeriFone began losing money after it was acquired by Hewlett-Packard Co. in 1997. Gores Technology bought VeriFone from HP in 2001 for an undisclosed sum. Now VeriFone is profitable and plans to raise \$230 million in its initial public offering. There were 10 buyouts of tech companies last year, for a total of \$5.8 billion, according to Thomson Financial Venture Economics.

Still, G&H's debut deal illustrates how treacherous it can be to combine the volatility of tech startups with the swashbuckling ways of private equity buyouts. In the next few weeks, the firm is scheduled to close on the \$35 million purchase of a 50% stake in San Jose (Calif.) computer terminal maker Wyse Technology Inc. Yet the deal almost didn't happen. G&H was days away from signing a contract with Wyse a year ago when its potential co-investor, buyout shop Texas Pacific Group (TPG), backed out. At the time, Garnett wasn't sure his firm, which hadn't yet closed on its \$250 million fund, could survive the blow. Only by pulling out of the Wyse deal, completing the fundraising, and the soothing Wyse's owners were Garnett and his partner able to complete their initial transaction.

GARNETT & HELFRICH
Their firm was founded to seek out tech fixer-uppers

The really hard work lies ahead. Wyse briefly held the spotlight in the mid-1990s when its stripped-down computers, called "thin clients," were promoted as replace-

Second Acts

Thousands of startups got funding and then stalled. Buyout firms bet they can help some grow again.

WYSE TECHNOLOGY

Buyout firm Garnett & Helfrich cut a deal to acquire 50% of this computer terminal maker for \$35 million. It plans to boost Wyse's revenues from \$175 million to \$1 billion by 2009.

VERIFONE HOLDINGS

Gores Technology Group acquired this money-losing credit-card reader division from HP in 2001. The company has since turned profitable and filed in January to raise \$230 million in an IPO.

PROXICOM

The Net consultant went public in 1999 and was bought by Dimension Data Holdings in 2001. Gores Technology Group acquired the division last year, betting that it can perform better independently.

ECOMETRY

The software house went public in 1999, stumbled after the bubble burst, then went private in '02. Golden Gate Capital acquired it last year, buying out founders and giving execs more equity.

Fighting Cancer



Extending Life

Science For A Better Life



Last year around six million people died of cancer – equivalent to the population of Hong Kong or Rio de Janeiro.

Improving diagnosis and finding more effective treatments of this pervasive disease are major challenges for the coming decades.

Bayer HealthCare is working tirelessly to improve both cancer diagnosis and the monitoring of cancer therapy.

In addition, Bayer scientists are currently working on ways to inhibit the growth of tumor cells. Helping to extend life when it is at its most precious. www.bayer.com

The New Bayer:

CropScience

MaterialScience

HealthCare

COMMENTARY

BY PETER BURROWS

Ousting Carly Was Just the Start

To succeed, Hewlett's board needs new blood

ments for the PC, but the company's growth has stalled in recent years. Now G&H is betting it can push Wyse's revenues from \$175 million last year to \$1 billion in 2009. The idea is to promote thin clients in developing countries where PCs may be too expensive for many buyers, and to increase revenue from its Rapport software, which manages Wyse's terminals as well as devices like cell phones. "My job is to get this company growing very, very quickly," says John Kish, Wyse's CEO.

Garnett and Helfrich first spotted the opportunities in small tech buyouts when they were VCs at Venrock Associates and ComVentures, respectively. In 2002, Venrock had co-funded a \$14 million buyout of security software maker PGP Corp. from McAfee Inc. Sales rose quickly at the newly independent PGP, and within six months it was bringing in more cash than it was spending.

In July, 2003, the duo quit their jobs, formed G&H, and hit the road to raise their first fund. In the process, they met James G. Coulter, co-founder of Texas Pacific. Intrigued by the pair's approach, Coulter said that if G&H found any attractive deals before it finished raising its fund, TPG would consider loaning the new firm the necessary capital and co-investing. G&H quickly set its sights on Wyse. After an October meeting with Coulter, Garnett thought G&H and TPG had a deal to split a 50% stake in Wyse.

Yet the deal never really fit at TPG, a common problem for small tech buyouts. Wyse was too small to produce significant returns for the firm's \$4 billion U.S. buyout fund, and it was too big for the \$400 million venture-capital fund. In January, 2004, after Garnett and Helfrich hammered out a six-page document detailing the deal's terms, Coulter called to say TPG wasn't interested. "We weren't laughing," says Helfrich.

G&H had to tell its investors, which include Harvard and Stanford universities, the deal had hit a roadblock. Still, G&H closed its fund without losing any investors. That summer, the pair reignited talks with Wyse.

Despite the snafu, G&H's investors think the firm has loads of potential. "What has gone on in the venture industry in the last decade has created an opportunity now on the buyout side," says Catherine Crockett, a general partner at Grove Street Advisors LLC. Whatever the risks, the time seems to be right for salvage capital. ■

—By Justin Hibbard in San Mateo, Calif.

CARLY FIORINA remains as much a magnet for headlines now that she's gone as she was when she was running Hewlett-Packard Co. But just as much attention should be paid to the role of HP's board in the tumultuous events of recent years.

Yes, HP's board deserves credit for taking action to oust one of the world's most famous and charismatic CEOs—something too many boards lack the courage to do. In particular, director Patricia C. Dunn, a longtime exec at Barclays Global Investors, was instrumental in building a consensus to push out Fiorina and then taking on the role of non-executive chairman. Yet a close examination of Fiorina's stormy tenure shows that the board waited too long to act and all too often succumbed to Fiorina's powerful brand of salesmanship since hiring her in 1999. That allowed her to pursue plans and tactics that have hurt HP's business and its standing with investors, employees, and customers.

Now, as it embarks on a search for a new CEO, the HP board should take steps to reform itself. Most important, the board needs fresh blood—top-notch directors with the tech savvy to help the company forge a new future.

How did the board fall short? Start with Fiorina's hiring. It's often forgotten that by the time Fiorina was named as the first outside CEO of HP, she was competing in a field of one. Qualified

outside candidates, such as former Oracle Corp. President Ray Lane and Motorola Inc. CEO Edward Zander, had taken themselves out of the running. Both did multiple interviews for the job but ultimately backed away. Among the reasons, they were put off by the board's request that they take a 34-question psychological exam. "That worried me," said Lane in a 2002 interview. "What kind of board am I going to be working for? I thought it was a silly thing for a CEO to be asked to do."

Then there's the board's oversight of Fiorina. When she arrived, the career sales and marketing specialist had never been a CEO, never worked in the computer or printer business, and never logged any big-time operating experience. She brought a much-needed sense of urgency to the company and centralized its sprawling operations. Yet the board let her press her ambitious, top-down overhaul to the point

that it tore at the corporate culture, the famous HP Way, which was built on pushing authority out of the business units.

Next, in 2001, came the \$19 billion merger with Compaq Computer Corp. For starters, the board never met without Fiorina present to discuss the idea, former director and company scientist

Walter B. Hewlett has said. When dismayed investors drove the stock down nearly 30% the weeks after it was announced, the board never seriously

reconsidered the deal. Instead, it did what it could to stifle Hewlett's objections to the acquisition. After Hewlett launched a proxy fight to stop the merger, HP's directors approved manag-



ON WHOSE SIDE?
"I didn't join HP," said Knowling. "I joined Carly."



GUTSY Dunn, now non-executive chair, oversaw the effort to sack Fiorina

ment's public-relations campaign to marginalize him as a cello-playing dilettante, too attached to the good old days.

The board also gave its tacit consent to more worrisome tactics. To ease investors' concern about Fiorina's lack of operational chops, officials repeatedly argued that Compaq CEO Michael D. Capellas would stay at the company to handle the day-to-day duties. But the board knew that was unlikely, because Capellas had a contract that granted him \$14.4 million if he left within one year of the close of the deal. That buyout wasn't made public until after Capellas jumped ship to run MCI Inc. "The No. 1 duty of a board is to communicate honestly," says corporate governance expert Jeffrey Sonnenfeld, president of the Chief Ex-

ecutive Leadership Institute. "By commission and omission, it was deceitful."

Following the departure of Capellas in late 2002, directors pressured Fiorina to appoint a chief operating officer. A simple solution presented itself in late 2003: Longtime HP executive Webb McKinney had finished helping lead the integration of HP and Compaq. According to several insiders, he was interested in the COO job. Fiorina refused to fill the post. The board should have forced her hand.

Finger-Pointing

INDEED, THE BOARD'S kid-glove handling of Fiorina only exacerbated the problem of HP's weak bench. Several top execs have bolted over the past 18

months, including Mary T. McDowell, a former top server manager who is now an executive vice-president at Nokia Corp. And when the company missed its third-quarter numbers last year, Fiorina promptly fired three high-ranking sales executives. "How could they let her go on this finger-pointing campaign?" wonders Sonnenfeld, who says that IBM's board rebuked then-CEO John Akers for similar actions in the early 1990s. The point: HP should have held Fiorina accountable rather than condone public firings that could hurt the company's efforts to attract and retain talented leaders.

Fast-forward to the present. As the HP board begins the search for a new CEO, it should remake itself by bringing in some new directors. Who should leave to make way? A good place to start may be former Ameritech Corp. executive Robert E. Knowling. Since Fiorina invited him onto the board in 2000, Knowling's allegiance has seemed more toward her than to HP's investors. "I didn't join HP. I joined Carly. If she left tomorrow, I'd resign tomorrow," he said at the time. Then there's Verizon Communications Inc. President Lawrence T. Babbio Jr. Both he and Knowling were on the compensation committee that signed off on Fiorina's \$21 million in severance and related farewell payments. Plus, an insider says they were the only two board members to oppose Fiorina's ouster. Neither Babbio or Knowling responded to requests for interviews.

Many people close to HP are calling for the head of Richard A. Hackborn. A brilliant strategist who started HP's lucrative printer business, he was instrumental in choosing Fiorina and was a key champion of the Compaq merger. "Given his support for Fiorina, many of us felt he should have resigned as well—for the same reason: She didn't succeed," says Carl Snyder, HP's former head of procurement before he retired in 2000.

Trouble is, Hackborn is the only bonafide tech visionary on the board. There also are no outside CEOs on the board, which is very unusual among the top tech companies. All of this points to a pressing need: new faces that can bring fresh ideas. "I don't see a lot of people there that have the breadth of understanding about where the industry is heading," says Jay W. Lorsch, a professor at Harvard Business School. Having mustered the courage to change HP's chief executive, the board now needs to be just as courageous in changing itself. ■

Mad Cow's Stubborn Mystery

Scientists still know far too little about it—and the feds are making rules in the dark

NEARLY A DECADE AGO, clusters of young people in Britain started suffering mysterious symptoms. First they became depressed and withdrawn, prone to crying fits, anxiety attacks, and bouts of physical pain. Within months they lost the capacity to remember or speak, then they slipped into comas and died. Autopsies showed brains ravaged by a novel form of bovine spongiform encephalopathy (BSE), or mad cow disease, which they contracted by eating infected beef. Public health experts feared an epidemic, with some predicting that tens of thousands of people would eventually die.

So far the predictions appear overly alarmist. Only 159 people worldwide are known to have died from eating BSE-infected meat—including a Japanese man whose death from the disease was con-

firmed on Feb. 3. But each new case is a painful reminder of the unanswered questions that swirl around mad cow and similar scourges in sheep, deer, and elk. Despite a decade of intense investigation, scientists still disagree about how these diseases are transmitted, how long they can incubate without symptoms, if they can be cured, and what steps should be taken to lessen the toll. In recent months scientists have made some startling discoveries. Yet they are dismayed that mad cow is so slow to yield its secrets.

Those many uncertainties are in the spotlight right now as the Agriculture Dept. prepares to resume trading of some live cows and packaged beef with Canada on Mar. 7. Restrictions have been in place since May, 2003, when a mad cow was discovered in Canada. Three more have been found since, including one animal that was imported to the U.S. and slaughtered in December, 2003. The USDA is torn between its mission to protect public health, its commitments to meatpackers and ranchers who want access to Canadian cattle, and its desire to facilitate U.S. exports. The problems won't be resolved until scientists get a firmer grip on the pathology of the disease.

Scientists such as Dr. Stanley B. Prusiner, a neurologist at the University of California at San Francisco, are making progress. Prusiner won a Nobel prize in 1997 for his discovery that proteins in the brains of

mad cow victims—both animal and human—exhibit characteristic malformations. These proteins, called prions, exist in a benign form in many bodily tissues. But when they become misfolded, they can turn both toxic and infectious, eating holes in the brain.

SLIPPING THROUGH?

PRUSINER'S THEORY isn't universally accepted. But his experiments continue to illuminate the prion theory. In June, Prusiner's team at UCSF reported that they had synthesized prions to resemble the disease-causing counterparts. The scientists injected the lab-made prions into mice, and more than a year later the rodents developed diseases that resembled mad cow. "This tells us that prion diseases can occur in many forms," says Giuseppe Legname, UCSF neurologist. That's the case, he adds, some people who die of undiagnosed brain diseases may actually be infected with prions that are slipping by undetected. "That has qui-



NORMAL human brain tissue

RAVAGES of mad cow disease

Piecing Out the Puzzle

THE GOOD NEWS...

Fewer people are dying from variant Creutzfeldt-Jakob disease, the human form of mad cow disease, than originally feared.

- Cases projected in 2000: up to 136,000 by 2060
- Actual deaths so far: 159

Data: British Health Dept.; Case Western Reserve University; Wellcome Trust Centre for the Epidemiology of Infectious Diseases; the European Commission

...AND THE BAD

Mad cow is caused by malformed proteins that eat holes in the brain, nearly always leading to death. Scientists seek to learn:

- why the proteins deform
- how they trigger mutation in other proteins
- why the disease affects only a subset of those exposed



CALGARY BEEF
Limited trade
with Canada
will resume
on Mar. 7

lightening implications," Legname says.

Scientists across the pond are also chasing elusive rogue prions. In December, British researchers reported that some humans appear to be protected from BSE by their genetic makeup. But they also found that even the mice that had the same genetic barrier eventually developed a form of prion disease—one that had never been seen before.

To determine if humans might be infected with yet-undiscovered strains of prion diseases, the researchers are urging health authorities around the world to perform more autopsies on people who die of mysterious brain disorders. Part of the goal is to see if other prion-based illnesses—such as chronic wasting disease in deer and elk—are jumping from animals to humans. In the U.S., for example, the Centers for Disease Control is funding scientists in Colorado and Wyoming who are checking death records against hunting licenses. They're trying to determine if any hunters got sick from eating game.

So far they haven't found any evidence of a link.

The only way to confirm and identify prion diseases today is to examine brain tissue after death. Only about 66% of suspected cases are autopsied each year. The number should be 75% or more, says Dr. Pierluigi Gambetti, director of the National Prion Disease Pathology Surveillance Center at Case Western Reserve University. He likens the current situation to a faulty airport security system in which there are multiple lines of passengers subjected to different levels of scrutiny. "How would you feel if one line of people went through unchecked?" he asks. "We may be missing that critical case that tells us chronic wasting disease is passing from animals to humans." With funding from the CDC, Gambetti is setting up autopsy centers in state health de-

partments around the country that will subsidize the procedure for families who can't afford it.

Scientists at the National Institutes of Health are grappling with the prion-disease problem lower down on the food chain. The NIH's Rocky Mountain Laboratories in Hamilton, Mont., has launched a number of studies designed to unravel the mysteries of cross-species transmission. In a series of experiments they injected a hamster form of corrupted prions into mice. The mice were not visibly affected, but when tiny bits of their brains were injected back into healthy hamsters and mice, some rodents got sick. Eventually specific strains developed that could kill mice, hamsters, or both.

LAYING BLAME

GIVEN HOW MUCH remains unknown, U.S. restrictions on Canadian cattle and beef seem prudent. But there are economic costs. Tyson Foods Inc. took a \$61 million charge against its fourth-quarter earnings last year because it couldn't import live cows from Canada. Nor could it export beef to Japan and other countries that restricted imports of American beef in the wake of the 2003 incident. The National Cattlemen's Beef Assn. (NCBA) reckons the U.S. has lost \$3 billion in export sales since those bans went into place.

Who is to blame? Consumer groups say the beef industry got the U.S. into this predicament by consistently thwarting calls to test cattle more aggressively. And even some within the NCBA agree that further research is urgently needed. "We should follow the science," says Gary Weber, an executive director at the NCBA.

Some good news has emerged from Britain. In a recent study, 12 patients with the human form of BSE had a drug normally used to treat urinary tract infections injected directly into their brains. This seems to have cut prion production and limited brain damage. Two years later, only one patient has died. "Five years ago, no one was even thinking about treatments," says Dr. Stephen

Dealler, a medical microbiologist at Britain's Lancaster Royal Infirmary who studies prion diseases. "I am very hopeful." It's a tiny bit of headway in the global effort to understand—and ultimately conquer—one of the world's most puzzling scourges. ■

—By Arlene Weintraub in
New York, with
Kerry Capell in London

**Other brain
diseases
could be
undetected
prion
infections**

REWIRING THE

First came pacemakers. Now exotic implants are bringing new hope to victims of epilepsy, paralysis, depression, and other diseases

BY MICHAEL ARNDT

REED S. KOHN HAS DONATED HIS brain to science. An epileptic since he was 8 years old, Kohn has tried everything from experimental drugs to harrowing surgery to control his seizures. Time and again, neurosurgeons have taken out bits of his brain that spark his hallucinations, or auras, and have severed nerves that enable aberrant electrical impulses to arc from lobe to lobe and generate a full-blown seizure. They have also run filaments to a nerve in his neck and to the core of his brain to microshock the disease into submission. Inevitably, though, the illness reemerges, corrupting a new clump of brain cells, and he is disabled once again. A college grad and certified computer programmer, Kohn lives with his parents at age 34 and has never had a job. Since his first seizure in 1978, he figures he has had 10,000 more.

His life may get better. Last fall, Kohn underwent his 12th operation. First, doctors scrutinized images of his brain as it malfunctioned. Then, guided by these scans, they wired electrodes to eight "hot spots" deep in his brain, and implanted under his skull a pacemaker-like device from NeuroPace Inc. in Mountain View, Calif. About the size of a microcassette tape and only a bit heavier, it houses a microprocessor programmed to detect the brain-wave pattern that precedes a seizure. Whenever this pattern arises, it immediately zaps the trigger sites with tiny jolts of electricity. The goal is to override his abnormal synapses and

MICHAEL L. ABRAMSON

A composite image featuring a man's profile in the foreground, looking towards the left. The background is a blue-toned medical scan of a human head, with a white, glowing, abstract pattern resembling a brain scan or neural activity overlaid on the right side. The word 'BODY' is printed in large, white, sans-serif capital letters in the upper left corner.

BODY

CALMING EFFECT

Doctors wired electrodes to "hot spots" in Kohn's brain. Tiny jolts of electricity have reduced markedly the frequency of his epileptic seizures

restore normal brain activity before Kohn is even aware that a seizure is brewing.

Since the operation on Oct. 14, Kohn has been averaging 10 to 15 seizures a month, down from 50 to 70. As a veteran guinea pig, Kohn knows that it takes at least six months before anyone can truly gauge how well a treatment works, so he doesn't want to rush to judgment. "I'm feeling pretty good," he says. His doctors, who believe they can lower that rate by tinkering with the device's settings, are less guarded. "We've been looking for solutions for a long time," says Dr. Richard W. Byrne, a neurosurgeon at Rush University Medical Center in Chicago who installed the device. "This could be it."

Forty-five years ago, doctors successfully implanted a cardiac pacemaker for the first time in the U.S., providing long-term hope for millions of people with heart disease and creating what has become a hugely profitable—and still fast-growing—\$10 billion-a-year business. Now, electrical therapy may be approaching an historic transition. Using advances in pacemaker technology, researchers and doctors are finding that rapid-fire bursts of low-voltage electricity can alleviate symptoms in an astonishing number of illnesses in many other parts of the human body. Scourges such as depression, post-stroke paralysis, migraines, sleep apnea, angina, obesity, tinnitus, and digestive tract disorders all may be treated with neurostimulators by the end of the decade. If early-stage experiments pan out, Alzheimer's disease, obsessive-compulsive disorder, Tourette's syndrome, bulimia, and other brain ailments could be next.

Mysterious Ways

MANY DOCTORS ARE THRILLED by this emerging vision of the body electric because it provides fixes beyond the ken of the medical mainstream. Life sciences today are heavily swayed by recent advances in molecular biology. The Human Genome Project and other well-funded efforts have cracked some of the inner workings of genes and the biochemical pathways of disease. In contrast, science has paid less attention to the role of electricity, which governs everything from the ethereal transmission of thought to the rhythmic music of the heart. The race to design and test new implantable devices could help correct this imbalance.

The high-tech implants are neither cheap nor risk-free. For one thing, they must be replaced every 5 to 10 years. Why they work is also still something of a mystery. What's more, neurostimulation won't cure most diseases, even though it eliminates or alleviates some symptoms. Doctors note that much of the research is in an early stage. It could be 10 years before they can say for sure if some devices are a fix—or a flop.

But the potential upside is great. Unlike most drugs, these implants produce few side effects. And while they might be a burden on insurers initially, studies show that they should save big bucks on hospitalization over time. The devices also are aimed at prevalent diseases that can't always be treated with drugs. As a result, medical-products executives and their surgeon partners predict that such implants could one day become as common as cardiac devices, which are currently helping 2 million Americans.

Little wonder, then, that some of the biggest names in health care are in a scramble to get into the market. Most recently, in December, Johnson & Johnson bought implant-maker Guidant Corp. for \$23.9 billion. "Any organ that a nerve can influence—and that's every organ in the body—can be affected using this technology," says Dr. Ali R. Rezai, who is director of

THE BODY ELECTRIC

Devices emitting microshock and electrical signals are helping patients with more and more kinds of ailments.



EPILEPSY AND DEPRESSION

Electrical pulses hit the vagus nerve in the neck to treat both of these disorders. They're generated by a device implanted in the chest, with wires running up the neck. *Cyberonics*

BLADDER INCONTINENCE

A device in the abdomen pulses the sacral nerve as it emerges from the lower spinal cord, causing the bladder to tighten.

Medtronic, Advanced Neuromodulation, and Boston Scientific's Advanced Bionics unit

CHRONIC PAIN IN THE BACK OR LEGS

Electrical stimulation of the sacral nerve as it emerges from the lower spinal cord overrides pain impulses. The source is a device implanted in the abdomen.

Medtronic, Advanced Neuromodulation, and Boston Scientific's Advanced Bionics unit

functional neurosurgery at the Cleveland Clinic. "It's a new era in neurology."

The use of implantable mini-generators is more widespread than you probably think. Already, 190,000 patients are wearing electrodes in their heads to control Parkinson's disease tremor or spinal-cord stimulators to relieve pain or prevent urinary incontinence. Some 30,000 have wires threaded to the vagus nerve in the neck to treat epilepsy, while 60,000 have microtransmitters in the inner ear enabling them to hear. These numbers are likely to grow—and quickly. One of the most promising

HEARING

Hearing implants transmit electrical signals from the inner ear to the brain, which interprets them as sound. An external apparatus is also worn behind the ear. **Boston Scientific's Advanced Bionics unit**

MIGRAINE HEADACHES

Electrical pulses are directed to the occipital lobe of the brain. The implant site is at the base of the skull. **Medtronic and Boston Scientific's Advanced Bionics unit**

POST-STROKE PARALYSIS

Embedded in the chest, a device stimulates part of the fibrous membrane surrounding the brain. The voltage is delivered by wires running up the neck and through the skull to a site directly above the area damaged by stroke. **Northstar Neuroscience**

PARKINSON'S DISEASE

Electrical stimulation of the thalamus, deep within the brain, halts otherwise uncontrollable tremors. The device is placed in the chest near the collarbone, with wires running up the neck and through the skull. **Medtronic**

A NEW PATH TO WEIGHT LOSS: PACE YOURSELF

Medtronic and Transneuronix both are testing pacemaker-like devices about the size of pocket watches that could lessen hunger pangs and help obese patients shed pounds. The procedure is performed on an outpatient basis in less than one hour.

A potential alternative to stomach-stapling, the device is implanted through a 3.5-inch incision just under the skin in the abdomen. Two leads attached to the exterior of the stomach wall deliver mild bursts of electricity.

Devices is a \$15,000 neurostimulator for chronic depression from Cyberonics Inc., which the Food & Drug Administration conditionally approved on Feb. 2.

Candy Bradshaw can testify to the power of neurostimulation. She had a gastric pacemaker implanted in her abdomen in 1999 at Tufts-New England Medical Center in Boston as part of an early-stage trial sponsored by Transneuronix Inc. Today, Bradshaw, 47, weighs 200 pounds, down from 280 before surgery. She still has to watch her diet and exercise regularly. But the device makes her feel full sooner than before, so she eats

less. "What it has done is fantastic," says Bradshaw, an office manager in Worcester, Mass. Executives of Transneuronix in Mt. Arlington, N.J., say the implant, now in a pivotal trial, could be available as a less-invasive alternative to stomach stapling within three years.

At Indiana University Medical Center in Indianapolis, researchers hope neurostimulators might enable paraplegics to walk again. Their device beams microvolts of electricity through six surgically installed electrodes to the site of a spinal cord injury. The electric field reverses direction, or oscillates,

every 15 minutes. In a just-completed experiment on 10 volunteers, oscillating stimulation helped nerves regenerate after 14 weeks of treatment, say doctors in the study, a joint venture between Indiana University and Purdue University. Two patients even recovered some movement in their legs, and one man who had been impotent regained sexual functions. Doctors, fully aware that earlier efforts in this area failed to achieve results, now are screening paraplegics for a second round of trials.

Infection Risk

AS NEUROSTIMULATORS GET EVEN SMALLER and their microchips more powerful, researchers foresee new uses for these implants. Advanced Bionics Corp., a startup that Boston Scientific Corp. acquired in 2004, is testing a rechargeable device so tiny that it can be injected almost anywhere in the body to treat pain or muscle dysfunction. Implants also could act as sensors,

telling a miniature pump when to deliver a drug or custom protein to a precise location in the body. "The body is on fire with electricity," says Dr. Stephen N. Oesterle, chief medical officer at Medtronic Inc., the No. 1 maker of implantable electrical devices. "If you start with that concept, then all you need is imagination."

As with any invasive procedure, there are dangers in implant surgery. When a cardiac device is implanted, for example, the rate of infection is 3% to 4%, which is twice the average rate of surgery in general. Batteries in these devices last only 5 to 10 years, which means patients may need a second implant. (A second operation is generally easier and less costly, since the electrical leads can be left in place.) Some device experts have expressed concerns about airport scanners interfering with implants. And the devices can fail. Last year, Medtronic had to recall thousands of defibrillators after discovering that their batteries were running low too quickly. At least four people died as a result of the product defect. On the other hand, sick people often undergo other therapies, or doing nothing. All in

"these are low-risk products," says Stuart M. Portnoy, a former cardiac device specialist at the FDA and now an industry adviser with PharmaNet, a Princeton (N.J.) consultant.

The neuromodulation market is potentially enormous. There are up to 3 million Americans with chronic pain, 3 million with depression and 4 million with depression who do not respond to drugs. The number of morbidly obese American adults is also estimated at 4 million. An additional 5 million Americans have been crippled to some degree by stroke, and the number grows by about 750,000 each year. Most of these people won't rush to surgery. But if only a fraction get an implant, executives at medical device companies project that overall sales of noncardiac pulse generators should balloon from \$1.6 billion today to \$10 billion in 10 to 15 years, depending on how quickly the FDA approves new uses. "Ultimately," says Todd K. Whithurst, vice-president for emerging indications at Advanced Bionics in Valencia, Calif., "this is going to be as big as cardiac-rhythm management."

The returns for investors may also be substantial. Today, most neurostimulators don't make money because years of research and development and marketing outlays overwhelm what are, at the beginning, only trickling revenue streams. Still, Advanced Neuromodulation Systems Inc., of Plano, Tex., averages gross margins of 70% on its spinal cord device for chronic pain. Houston's Cyberonics, Medtronic, and Boston Scientific—the other companies with FDA-approved neuromodulators—all boast even fatter margins.

As sales grow, device makers will be able to spread their expenses over a wider base and become more efficient manufacturers. If the FDA approves

WHO'S WHO IN NEUROSTIMULATION

The market for implantable devices could double every five years. That's attracting health-care giants and startups.

DIVERSIFIED GIANTS

BOSTON SCIENTIFIC (BSX)

A leading maker of coronary stents, Boston Scientific jumped into the neurostimulation market last June. It paid \$740 million for Advanced Bionics, a \$100 million-a-year startup. More acquisitions may lie ahead. Total sales: \$5.6 billion Net income: \$1 billion Forward p-e: 14.1

JOHNSON & JOHNSON (JNJ)

J&J got into cardiac devices through its takeover of Guidant, itself a newcomer to neurostimulation. J&J believes the market will grow quickly, and its marketing prowess and deep pockets could make it a winner. Total sales: \$47.3 billion Net income: \$8.5 billion Forward p-e: 17.5

MEDTRONIC* (MDT)

The pioneer in pacemakers and defibrillators, Medtronic is also the leader in adapting this technology for other treatments. Its focus on implantable devices gives it an edge over rivals. Total sales: \$9.9 billion Net income: \$2.2 billion Forward p-e: 23.9

PURE PLAYS IN DEVICES

ADVANCED NEUROMODULATION SYSTEMS (ANSI)

ANSI has been growing at a 30% clip or better. But while it is in tests for expanded uses of its neurostimulators, company execs concede they probably need the help of a diversified giant to continue growing. Total sales: \$121 million Net income: \$18 million Forward p-e: 23.7

CYBERONICS* (CYBX)

A patent gives Cyberonics a near-monopoly on the market for vagus-nerve stimulation. One product treats epilepsy. And the FDA has conditionally approved a device for depression. The company could be a takeover play. Total sales: \$103 million Net loss: \$7 million Forward p-e: NA

SMALL FRY

NEUROPACE

Mountain View, Calif. The company is in clinical tests for brain stimulation to avert epileptic seizures. It hopes to be on the market by 2007.

NORTHSTAR NEUROSCIENCE

Seattle. In clinical tests for brain stimulation to reverse stroke-related paralysis. Next up: tests on cerebral palsy and trauma victims.

TRANSNEURONIX

Mt. Arlington, N.J. Has a product now being tested for stomach stimulation to treat obesity. It's already on the market in Canada.

*Medtronic and Cyberonics results are for the twelve months ended Jan. 28, 2005

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their new treatments, says Jan D. Wald, a medical-device analyst at A.G. Edwards & Sons Inc. in Boston, pretax earnings at the smaller companies should rise to 20% to 30% of revenue, equaling the return on more established products such as pacemakers. "The market is close to an inflection point," he says. Mark Landy, an analyst at Susquehanna Financial Group in Bala Cynwyd, Pa., also sees the market growing by 20% for the next several years. For now, though, he cautions against buying these stocks, saying the share prices are already based on outsize returns.

Nevertheless, as more patients request implants for conditions that drugs can't treat, the creaky health-care system will have to brace itself for yet more financial strain. Today, a patient with migraines might get by on \$10 a day for drugs. A neurostimulator, by comparison, typically costs \$15,000, or about as much as a heart pacemaker or defibrillator. The total bill can hit \$50,000 with doctors' and hospital charges. Equipping just 10% of the estimated 500,000 Americans with epilepsy that drugs can't help could cost \$2.5 billion. Even amortized over the average 7½-year life of a device, that \$50,000 would cost about \$17 a day.

Too Much of a Good Thing?

BEYOND THE STICKER SHOCK, officials at the government's Centers for Medicare & Medicaid Services (CMS) also worry that, as with other glitzy treatments, too many of these devices might end up in patients who don't really need them. Sean Tunis, the agency's chief medical officer, points out that the nation might get more bang for the buck if physicians did less expensive things first—for instance, routinely screening people for depression and putting them on medications before their conditions become untreatable. "There's no end to the numbers of new devices that are being developed, but there is a limit to how much employee-benefit plans can absorb," warns Karen Ignagni, chief executive of America's Health Insurance Plans, a trade group representing the major health insurers.

Over time, however, these devices may restore more than lives; they could save money, too. In a comprehensive review of spinal-cord stimulation, a doctor and an economist at Maastricht University Hospital in the Netherlands reported in 2002 that the cost of implanting the device was offset by savings on physical therapy and other expenses in 2½ years. The study's authors, who tracked 54 patients over five years, also extrapolated that over a lifetime, each patient would save \$60,000. CMS and most major private health plans such as Blue Cross Blue Shield Assn. cover implants for FDA-allowed devices, although reimbursement rates and prerequisites for surgery vary.

Neurostimulation has another selling point: Because the implants alter tissue only at their points of contact, side effects are generally negligible. In epilepsy patients with electrodes implanted to pulse the vagus nerve, the most dire side effect is



DOWNSIZED
Bradshaw, 47, weighed 280 pounds before she got a gastric pacemaker. Now she's at 200

hoarseness, sometimes accompanied by the desire to clear throat. Only 3% of such patients report this minor complication. Most say they can't sense stimulation at all. Contrast that with the most common drug treatment, Dilantin, which can cause dizziness and nausea and can lead to liver damage. "Think of the device as a smart bomb," says Advanced Neuromodulation CEO Christopher G. Chavez.

Medical-device executives and surgeons point out that today's implants are not generally intended to be a first-line treatment. Someone with heart trouble, for instance, would start on a cholesterol-reducing drug and a stricter diet before getting outfitted with an implantable defibrillator. The same goes for neurostimulators, which are meant for patients with illness or disabilities for which there

are no other treatments. People like Judith Walsh of Elmhurst Park, Ill. In 1999, when Walsh was just 54, she suffered a stroke that paralyzed her entire left side. Thanks to aggressive physical therapy, she recovered the ability to speak—and also learned how to walk again. But her left arm remained atrophied, with her left hand permanently clenched in an almost-useless fist.

Last February, Walsh began electrical-stimulation therapy, a clinical study sponsored by Northstar Neuroscience Inc., doctors at Northwestern Memorial Hospital in Chicago implanted a pacemaker in her chest and tunneled wires up her neck to her head. They drilled through her skull to place an electrode pad about the size of a postage stamp on the protective membrane surrounding her brain, close to the swatch that had been killed by the stroke. The surgery took 90 minutes. For the next six weeks, even though she couldn't feel it, the device bathed the target site with electricity as she willed her left arm and hand to move during 3½ hours of supervised rehab every day. Then the implant and electrodes were surgically removed.

Today, Walsh can make a peanut-butter and jelly sandwich and grip the steering wheel of her car with her left hand. More gratifying, she says, she can feed and dress her five-month-old granddaughter, Emma, things she couldn't do with her three older grandchildren when they were babies. "It's hard, as

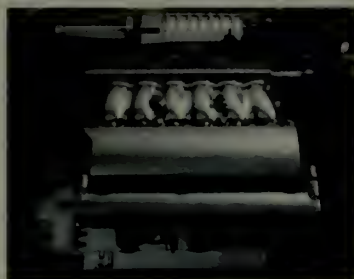
"It's hard, as a grandmother, not to be able TO HOLD the grandchildren," after a stroke

grandmother, not to be able to hold the grandchildren—and now I'm able to do that," she says. "It's the thrill of my life." Executives at Northstar, a Seattle startup financed by JPMorgan and Boston Scientific among others, are now negotiating the parameters of a final-stage clinical trial with the FDA.

The question remains: How do these devices all

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viate symptoms? In the case of rehabilitating stroke victims, doctors aren't sure whether the stimulation enables brain cells in proximity to the stroke site to learn new functions or whether the pulses instead are helping cells in stroke-damaged tissue regenerate. Similarly, doctors are baffled as they test pacemakers to treat obesity. They know the device stimulates nerves in the stomach to tell the patients they are no longer hungry. But they're not sure which organ is being tricked: the stomach itself or the brain. "There must be a central mechanism," says Dr. Jay B. Prystowsky, chief of gastrointestinal and endocrine surgery at Northwestern Memorial, "but the bottom line is we really don't know exactly how this works."

Burst of Uses

FOR SUCH BASICS still to be a mystery is odd, considering how long science has been studying electrical stimulation of the body. As far back as the late 1700s, experimenters showed they could make muscles twitch with shocks from static-electricity generators. By the 1930s, as engineers perfected how to control the frequency and flow of electricity, scientists were dabbling with battery-powered pacemakers to pulse the heart. These early devices were bulky, requiring patients to be anchored to an external contraption. Then in 1960, electrical engineer Wilson Greatbatch patented the first successful implantable pacemaker. Finally, in the mid-1990s, the FDA began approving pacemakers for uses outside the heart.

Now, after that initial burst of approvals, a raft of new treatments may be around the corner. On Feb. 2, the FDA cleared Cyberonics' vagus-nerve stimulator for chronic depression, pending some clarification on the labeling of the device. Chairman and CEO Robert P. "Skip" Cummins says Cyberonics analyzed results from 240 people with long-term depression after two years of neurostimulation.

All of the subjects had failed to respond to drugs. The analysis found that half the patients were markedly better, with 18% reporting they were no longer depressed. With the FDA's go-ahead, Cummins says, Cyberonics will begin pilot studies on Alzheimer's disease, headache, anxiety disorders, and bulimia. Medtronic also may be closing in on a

number of new therapies. Its products are in clinical tests to pulse the thalamus to treat epilepsy; another region of the deep brain to treat migraines, depression, and obsessive-compulsive disorder; the hypoglossal nerve in the neck to treat sleep apnea; the sacral nerve to treat bowel disorders; and the stomach to treat obesity. Medtronic may have a deep-brain treatment for epilepsy in two or three years.

New treatments may become feasible as device sizes shrink and rechargeable batteries evolve. Advanced Bionics, for example, has developed a rechargeable implant that is about the size of an ink tube from a ballpoint pen cut to a one-inch length. Its first use, already permitted in Europe, is to prevent bladder incontinence by stimulating the organ directly, rather than through the sacral nerve. The Boston Scientific subsidiary also has begun a stage-one trial to see whether the device can alle-

A next step: Linking stimulators to tiny **DRUG PUMPS** for precise doses



HAND IN GLOVE

Last June, Boston Scientific paid \$740 million for hot startup Advanced Bionics

viate chronic headaches by injecting it into the base of the skull to stimulate the brain's occipital lobe. And soon, company executives say, they hope to start testing the device in the leg and arm as a therapy for pain or carpal-tunnel syndrome.

The leading cardiac-device makers are packing their new implants with enough computing power to sense the environment around them and alter a patient's treatment as needed. The next step would be to link sensor-laden neurostimulators with miniature drug pumps. In this way, a patient could be dosed exactly when needed and at the precise site where the medication is most effective. Researchers say this could reduce dosages a thousandfold and avert side effects. Such systems would also enable a patient to be treated with bioengineered drugs and proteins too large to be absorbed by swallowing a pill. The combined therapy seems most promising in the brain, where many disorders might be tackled with protein drugs complemented by electrical pulses.

As these new therapies move closer to reality, the medical products companies are putting down their markers. Last June, Boston Scientific paid \$740 million in cash to acquire Advanced Bionics. Boston Scientific also holds a 14% stake in Cyberonics. Then in December came J&J's megadeal with Guidant. Although Guidant does not have any neurostimulators in clinical trials, the Indianapolis company has been earmarking an increasing share of its R&D budget for these devices. Some medical-products executives predict J&J or Boston Scientific could buy Cyberonics or Advanced Neurostimulation next.

Implants won't cure everything that ails us. The Parkinson's treatment, for one, stops tremors but can't halt the deadly disease. Yet the list of therapies is growing. And they all benefit from advances in microelectronics and our deepening understanding of the brain and nervous system. "These devices were science-fiction dreams 20 years ago," marvels Dr. Robert Levy, a Northwestern Memorial neurosurgeon who has seen neurostimulation give stroke victims like Judy Walcott use of their hands and arms again. The body, as medicine learns, truly is electric. ■

BusinessWeek online For Q&A's, including one with Medtronic's chief medical officer, Dr. Stephen N. Oesterle, and a slide show on the body electric, go to www.businessweek.com/extras

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Multibillion Dollar Baby

J.P. Morgan's John Miller is holding the hottest hand at the Oscars

WHEN THE OSCAR for Best Picture is presented at this year's Academy Awards on Feb. 27, Hollywood's most powerful banker won't be anywhere near the Kodak Theatre. Instead, John W. Miller, who financed three of the five finalists, will be in Kansas City at a family reunion. Six foot six with closely trimmed white hair, Miller "could be out of Central Casting if you were looking for a banker," says Lakeshore Entertainment Group producer Tom Rosenberg, "except that he is the most un-Hollywood guy in Hollywood." Rosenberg produced nominee *Million Dollar Baby* with part of a \$200 million line of credit from Miller.

Managing director of J.P. Morgan Securities' entertainment group, Miller, 59, shuns Tinseltown's glitz. He doesn't attend A-list parties, rarely hits the red carpet at premieres, and travels to the Cannes Film Festival each year only because that's where the deals are done. "I don't have to stay out late and watusi to understand this business," he says.

Indeed, the dozens of lucite "tombstones" that litter his spacious office in a

Century City high-rise commemorate three decades of arranging loans for most of Hollywood's biggest dealmakers. He has helped launch movie powerhouses such as DreamWorks, Revolution Studios, and Time Warner's New Line Cinema. His financing credits include three of the last five Best-Picture Oscars (*A Beautiful Mind*, *Gladiator*, and *American Beauty*), as well as *Ray* and *The Aviator* along with *Million Dollar Baby* this year. A Miller-financed action film, *Mr. and Mrs. Smith*, starring Brad Pitt and Angelina Jolie, is generating buzz though it won't be released until June.

How Miller figures out which films to back would make movie buffs groan. He's strictly a numbers guy. Although he often goes to the movies, he doesn't read scripts, doesn't care about plots, and doesn't worry about which stars have signed on—unless they threaten to bust the budget. He relies instead on a sophisticated financing model fueled by data on how more than 300 films performed at the box office. It allows him to tune out the noise and focus on what really counts in a movie's success: its business plan, especially its budget, release date, genre, and distribution schedule.

Unlike the industry he backs, Miller is no risk-taker. He issues loans for slates of

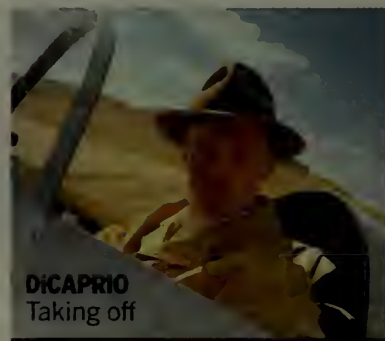


films at a studio—5 to 15 at a time—single flicks. He figures 3 of 10 movies do well and one will hit the jackpot, setting losses from the flops. "If you up to 15 films, it's hard to lose money on a slate," says Miller. What's more, he plays most of the loans with a syndicate of banks, laying off much of the risk.

WORKOUT BACKGROUND

MILLER HAS \$7.5 BILLION in loan commitments to production companies, but his bank is on the hook for only \$1.3 billion of it. David Hotkins, managing director of Imperial Capital Bank's entertainment finance division, says he has bought into some of the syndications largely because of Miller and his team's analysis of the risks. "They have such a wealth of knowledge about this industry that they cut the risks way down," he says.

Miller wields a big stick. To control Hollywood's spendthrift ways, his loan documents are loaded with covenants covering everything from limiting how much of the bank's money a producer can spend on a single movie to requiring O.K. before producers add financial partners or foreign distributors. Miller insists on quarterly reports to make sure pro-



The Envelope, Please

J.P. Morgan bankrolled slates of movies that include three that are up for Best Picture this year:

MOVIE	PRODUCER	LINE OF CREDIT* (MILLIONS)
<i>Ray</i>	Bristol Bay	\$300
<i>The Aviator</i>	Initial Entertainment	210
<i>Million Dollar Baby</i>	Lakeshore	200

* For slate of movies



**MILLER'S
GROSSING**
With *Mr. and
Mrs. Smith's*
Pitt and Jolie

lenders keep their promises, often sending audit teams to double-check. "He makes you work for your money," says Charlie Lyons, CEO of Beacon Pictures, which has a \$200 million credit line with Morgan. "It imposes discipline on you." Miller says he has never lost money on an entire slate of flicks "other than one time when there was fraud involved." But there have been a few close calls. In 1999, Miller sued insurers who had backed his loans but pulled out after movies such as *The Mirror Has Two Faces* and *The People vs. Larry Flynt* bombed. Miller says the bank ultimately prevailed, getting back \$500 million with interest. Miller's trusty model has kept J.P. Morgan in business arranging movie loans while studio bankruptcies and box-office disasters have forced out other banks. With 80% of the market, they own this business," says Hotkins. That allows Miller to charge interest rates of up to three percentage points over the rate that other banks pay to borrow from each other. That's on top of fees of up to 3% of the loan commitment, which is shared with banks in the syndicates. It makes for a lucrative profit center: Miller says margins for the business can reach 80% of revenues.

Fresh from the University of Arizona in 1968, Miller got his start at Union Bank of California in the humdrum world of workouts of bad loans to manufacturers. In the early '70s, looking to expand the Beverly Hills branch, he met business managers for celebrities such as Johnny Carson, Elizabeth Taylor, and Cary Grant. It was one of those contacts who told famed Hong Kong production house Golden Harvest to call Miller when it was looking to finance its latest movie, even though Miller had never done this type of work.

The movie never got made, but by working on the deal he gained entrée into the business and got known around the bank as the go-to guy for movie financing. He switched to Chase Manhattan Bank, now part of J.P. Morgan Chase, in the ear-

ly 1980s and never looked back. Today, he's the ultimate Hollywood insider, knowing who to back and who to avoid. "This is really a small industry," he says. "There is always someone you know who you can call up about the person you're dealing with."

DREAMWORKS BET

EVEN MAJOR STUDIOS seek Miller's imprimatur. When Walt Disney Co. was mulling putting \$65 million into Graham King's *Gangs of New York*, then-studio chief Joe Roth contacted Miller, Roth recalls, "to figure out who the hell this guy Graham King was." Miller vouched for him, and Disney advanced the money. Roth and Miller had known each other since the early '80s, when Miller had financed Roth's Tom Hanks film *Bachelor Party* and the slapstick *Revenge of the Nerds*. When Roth set up Revolution Studios in 2000, Miller provided \$600 million in financing—which Roth says has grown to \$900 million.

Miller has a knack for nurturing upstart filmmakers while keeping his exposure to a minimum. King, the head of Initial Entertainment Group, which made the Leonardo DiCaprio film *The Aviator*, says Miller gave him a tiny \$21 million line of credit in 1997 to make movies such as *Traffic*, which cost \$48 million and

grossed \$124 million in the U.S. Miller raised King's credit line to \$210 million so he could make such films as *Gangs of New York*. Rosenberg, producer of *Million Dollar Baby*, had to prove himself before Miller lent him his first \$10 million.

Morgan's biggest hit in Hollywood may well be the \$1 billion revolving credit it granted DreamWorks in 1992, along with financing for a Gulfstream IV for the studio's execs. The deal paved the way for the bank to be one of two lead underwriters for the \$812 million initial public offering

of DreamWorks Animation SKG Inc. last October, and for Miller to arrange another \$1 billion credit line for the studio.

Not quite an Oscar, perhaps. But Hollywood's banker didn't have to attend a fancy ceremony to claim his prize. ■

—By Ronald Grover in Los Angeles

Movies By The Numbers

When lending to a studio, Miller doesn't read scripts or worry about which stars have been signed. Instead, he focuses on:

WHAT business plan is being proposed, the budget's size, the financial partners, the genre of the movies, and their prospects in foreign, DVD, and other markets.

WHEN movies will be released. Scary movies do well before Halloween and flicks aimed at kids do best during school vacations.

HOW quickly the movies will be rolled out across the country—fast for potential blockbusters, slowly for films that need to build buzz.



Where VCs Fear to Tread

Angel investors are filling a critical gap by providing early backing for biotechs

WILLIAM H. EDWARDS isn't your typical biotech magnate. A few years ago, the 54-year-old Raleigh (N.C.) Realtor started to dabble in angel investing, doling out his own money to bankroll a handful of non-biotech startups. But when a friend went to work for Voyager Pharmaceutical Corp., a Raleigh company working on a drug to combat Alzheimer's, Edwards busted open his wallet—investing not just in its first financing round but in five subsequent ones that raised \$40 million total. Edwards is convinced Voyager has a good shot at producing a potential \$10-billion-a-year blockbuster. "It takes a small company sometimes to find a cure," he says.

Angels—rich private investors like Edwards—are flocking to biotech. And they're filling a critical financing gap. Venture capitalists are steering clear of startups, preferring to fund companies with

drugs nearly ready for market. Stock investors are equally wary, since one biotech initial public offering after another has nosedived this year. So angels are stepping up, betting that biotech is poised to deliver major drugs for everything from cancer to brain disorders. They poured \$1.98 billion into biotech last year, up 10% from 2003 and 52% from 2002, estimates Jeffrey Sohl, director of the Center for Venture Research at the University of New Hampshire.

While individuals have always played a key role in funding biotech startups, today's angels represent a new breed—one that bears striking similarities to venture capitalists. Angels increasingly are investing in later rounds of funding, even though they

GROUND FLOOR
Edwards is backing an Alzheimer's drug

have to shell more money for fewer shares than they got in earlier rounds. Many

gels have organized clubs, a handful which are dedicated solely to fund biotechs and other life-science companies. That helps them spread their and pool bigger sums of money. The making their picks by scrutinizing clinical trial data and grilling entrepreneurs just as VCs do. "Angels are getting more sophisticated," says Michael Barron, a partner in the Boston office law firm Nixon Peabody LLP.

NICE AND QUIET

BIOTECH EXECS LIKE the shift. Unlike VCs, angels don't try to take control. While VCs often demand perks—such as dividends when a company is sold—and shares come with fewer strings and don't reduce the value of the founders' shares as much. "When the VCs come in, early investors take a haircut," says Michael Giannini, Voyager's vice-president of business operations.

Life Science Angels Inc. is one of the latest examples of the new trend. The group, composed of 80 big Silicon Valley investors, formed in January and will hold its first meeting on Mar. 2. So far it has been inundated with 60 business plans from entrepreneurs seeking funding. Co-founder Allan W. May, chief executive of Vascular Architects Inc., a maker of medical devices based in San Jose, Calif., says many of the group's members are biotech industry vets, well aware of the risks of trying to find the next magic cure.

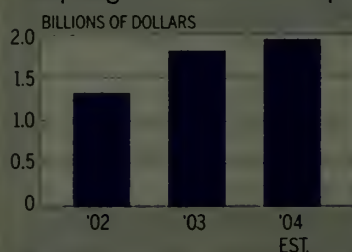
Those risks are compounded by the current dearth of strong IPOs, the traditional way early investors harvest their profits. Three of the four biotech IPOs far this year have raised far less than anticipated. Last April, Favril Inc., a San Diego company working on several cancer drugs, said it hoped to raise \$86 million.

By the time it hit the market on Feb. 10, it had halved its share price to \$7 and raised a little more than \$4 million. The stock has hovered around that offering price ever since. Meantime, several biotech IPOs have been postponed recently.

Instead of being scared off, angels have simply modified

PENNIES FROM HEAVEN

Angel investors—rich individuals—are piling into biotech startups



Data: Center for Venture Research, University of New Hampshire

ir tactics. Many are now looking for acquisition bids for their companies as a potentially more lucrative exit strategy. Though IPOs have faltered, there are plenty of eager private buyers for early stage biotech companies. On Feb. 1, Peninsula Pharmaceuticals Inc., based in Alameda, Calif., suspended its planned IPO, saying it was in discussions

to be acquired by another company.

The muted public market for biotech IPOs may actually be fueling the angel trend. When IPO markets are chilly, many biotechs go back to private investors to get the money they need to move their drugs along. With more biotechs competing for private funding, valuations in later rounds may be more affordable than

before, making it easier for angels to stay in the game longer.

Necessity has become a virtue for both angels and biotechs. And it could be the start of a lengthy relationship. The deep pockets—and strong stomachs—of angels will be important lifelines for biotech for some time. ■

—By Arlene Weintraub in New York

INVESTING

Tech IPOs: Here Comes The Next Wave

It had all the makings of a disaster. As the dot-com frenzy was peaking in 1999, former Netscape Communications Corp. executive Mike McCue founded TellMe Networks Inc. Within a year, the Mountain View (Calif.) maker of voice-application software had raised a huge \$232 million in venture capital. But by the time McCue banked the money in October, 2000, the boom had gone bust. Naysayers said TellMe would never return its backers' investment. Five years later, though, the company is poised to do that and more.

Remarkably, almost half of all the venture-backed startups from 1999 and 2000 have survived. A first wave went public last year, including Google Inc., and now a bigger wave of perhaps a few dozen outfits is set to follow. The best of the bunch, such as TellMe, sport fast-growing revenues and, in many cases, profits.

An old adage in the VC business holds that the best startups are built during bear markets. While the post-boom downturn didn't kill off every flimsy venture, it did impose frugality on many young outfits. "We saw a lot of companies forced to spend less money to acquire more revenue," says Kevin Harvey, a general partner at Benchmark Capital in Menlo Park, Calif. With fewer competitors, smart startups could quickly grab big chunks of their respective markets.

That's what happened at TellMe. While several competitors either folded or were acquired, the company stayed focused on winning large corporate clients that use its voice software for customer service. TellMe turned profitable last year after roughly doubling revenues in each of the last two years, and is on track to post \$100 million in sales this year. "They're going to queue



Public Ambitions

Here are the tech companies that look ripe for an IPO soon:

COMPANY	BUSINESS	2005 REVENUES (MILLIONS) *
Vonage Holdings	Internet phone service	\$100+
Fortinet	Network security equipment	100
TellMe Networks	Voice-application software	100
Force10 Networks	Networking equipment	50+

*Estimates Data: Companies BusinessWeek

the company up as a 2006 IPO and try to create a Google-like energy behind it," says one venture capitalist familiar with TellMe. McCue says the company is in a position to launch an IPO at any time but hasn't set a date.

Also mum about its plans is Vonage Holdings Corp. Founded in 2001, the Edison (N.J.) provider of Internet phone service has raised \$210 million and last year racked up about \$100 million in revenue. It has spent enough on marketing in a bid to make itself a household name, and several VCs say it will go public this

year or next. But critics complain that while its ads attract new customers, it doesn't retain as many as it should.

The networking equipment sector hasn't produced a blockbuster deal since NetScreen Technologies Inc. went public in 2001. But companies such as Force10 Networks, Peribit Networks, and Calix have since developed into serious IPO

contenders. "We spend a fair amount of time talking to the buy side, and the appetite is strong," says Andrew Feldman, vice-president of marketing at Milpitas (Calif.)-based Force10, which expects at least \$50 million in revenue and should turn profitable this year.

Since September 11, venture firms have pumped lots of capital into security technologies. Those investments have produced promising IPO candidates, such as Fortinet, CipherTrust, and ArcSight. Sunnyvale (Calif.)-based Fortinet, which aims to turn profitable in the third quarter, would like to go public later this year at a valuation of \$750 million to \$900 million, or five to six times its projected 2006 revenues, says Chief Financial Officer Harold Covert.

All the same, investors shouldn't get carried away. For every TellMe or Force10, there are hundreds of other companies that lack either the earnings or revenues to go public. Not that they won't try.

So far, IPO investors are keeping their standards high. The latest example: On Feb. 11, money-losing online retailer SmartBargains.com LP had to withdraw its IPO because of a lack of demand. With a backlog of quality companies itching to go public, buyers can still be picky.

—Justin Hibbard in San Mateo, Calif.



The Next Generation

For today's media execs,
digital is where the action is

BY TOM LOWRY

THE EMPIRES HAVE BEEN built. The mad land grabs in media and entertainment orchestrated by larger-than-life founders have run their course. A business that was once all about box office, TV ratings, and advertising is a new world in which technologies are untethering media from time and place. The people with the power in this amorphous universe aren't the old guys at the corner office but demanding newcomers who rule as never before. In this twilight of the moguls, a new, younger generation of executives is waiting in the wings to inherit an industry in upheaval. They're baby boomers with MBAs and law degrees. They are women. They have had media gigs in all parts of the business and the globe. They grew up embracing technology and know all too well that pirates lurk around every corner.

Sure, steely Viacom Inc. Chairman Sumner M. Redstone, 81, is still going strong. So is 73-year-old News Corp. founder Rupert Murdoch. But they are the last of a breed, the builders who helped define the modern media conglomerate by making their companies extensions of their own personalities. By now everyone has heard about the likely inheritors, News Corp. President Peter Chernin, the Warner Entertainment & Networks Chairman Jeff Bewkes, and Viacom Co-Chief Operating Officers Tom Freston and Les Moonves. But dozens of others climbing the corporate ladder are also vying to redesign media for the digital age.

There are executives such as Michael Lynton, 45, the understated, boyish-looking chairman of Sony Pictures Entertainment. A Harvard MBA fluent in four

languages, he worked in mergers and acquisitions on three continents for Credit Suisse First Boston, served as a radio exec at Walt Disney, ran Penguin Group, and later headed America Online's international business. There's Susan L. Decker, 42, who is bringing to her

THEIR WAY
dio One's Liggins,
dale's Levinson,
rtha Stewart's
ve, Comcast's
rke, and Bowman
MLB.com

chief financial officer post at Yahoo! Inc. the studied approach of a stock analyst (she was head of equity research at Donaldson, Luf-

kin & Jenrette Inc.) to help CEO Terry Semel win over Wall Street and Madison Avenue. And there's former AT&T veteran Dan Schulman, 46, CEO of wireless reseller Virgin Mobile USA, who marries content and hardware by putting hip ads and MTV clips on cell phones to lure media's ever-elusive audience, teens and the college crowd.

By all accounts they and others in their cohort are pragmatic and careful not to be too mogul-like, as apt to grab a sandwich on the run as take time for a power lunch at the Ivy or Michael's. In many cases they have focus groups for divining what is cutting-edge right at home—their own multi-tasking, media-mad children. "We are seeing a whole new group stepping out of the shadows of the tycoon figures," says headhunter James M. Citrin of exec-

keepers of old." The next step in media's evolution will most certainly shuffle the deck for the market leaders. Some may ultimately fail. Who emerges on top may be surprising as media's boundaries grow to include tech, phone, and wireless outfits. Just three years ago, who would have imagined that ring tones would become a \$3 billion-a-year music business.

THINKING IN MANY DIMENSIONS

THE CHALLENGES THESE inheritors face will surely test their skills. Now that media are no longer hard-wired and regulated, and digital technology is delivering content anywhere anytime, capturing a piece of the highly fragmented audience is tougher than ever. In the late 1950s, *Guns, Smoke* on CBS captured a 65% share of the TV audience nearly every Saturday night. Only one event, the Super Bowl, has a chance to do that now.

Today's executives have to manage in three dimensions—constantly imagining their books, magazines, movies, shows, and games in an array of digital forms. More and more you hear executives referring to cell phones as their third screen. "We are seeing a separation of content and distribution," says Wolzien. "Over time there may be 20 ways to get to the consumer." Consider this: Five years from now there will be 83 million homes with broadband connections—nearly as many as the 88 million that now have cable and satellite hookups, according to Bernstein projections. The number of wireless subscriptions in the U.S. will grow 20%, to 243 million, in the same period. Little of what works today is a given for long.

Even as media are available on a scale once unheard of, the industry is also increasingly vulnerable to piracy, the *bête noire* of today's media honchos. It used to be that the

first impulse of any strong leader was to club pirates with lawsuits. Now it's not that simple. Execs have to strike ticklish accords with all sorts of adversaries that may well be partners tomorrow, weighing the need to protect their content against the rush to the latest cool devices.

They also have to contend with wary investors, traumatized by AOL's disastrous acquisition of Time Warner and Comcast's failed bid last spring to buy Walt Disney. Where sweeping acquisitions once prevailed and EBIDTA (earnings before interest, depreciation, taxes, and amortization) measures sufficed,

Turbulent New World

Executives will confront big changes in the media biz in the next five years. A look at the shifting landscape:

AD DOLLARS WILL POUR INTO THE INTERNET...

	2005	2010
Internet	\$11.5 billion	\$19.2 billion
Broadcast TV	\$17.2	\$21.5

...HIGH-SPEED HOOKUPS WILL PROLIFERATE...

	2005	2010
Homes with broadband	42.4 million	83 million
Homes with cable and satellite	88 million	99 million

...WIRELESS USE IS EXPECTED TO EXPLODE...

	2005	2010
Cell-phone and PDA subscriptions	199 million	243 million

...AND MORE PEOPLE WILL CONTROL THEIR VIEWING

	2005	2010
Homes with a personal video recorder	12 million	31 million

Data: Sanford C. Bernstein & Co.

utive search firm Spencer Stuart, who is a matchmaker for this generation. "Today media executives need to have it all—that right balance," he says.

This changing of the guard comes as media are flourishing but also under enormous pressure, scrambling to stay ahead of every new gadget or innovation on the Net. "We're right at the precipice," says Tom Wolzien, an analyst at Sanford C. Bernstein & Co. and a former NBC executive whose musings on the latest media trends are widely read by many of the new managers. "The convergence to digital is here, and it's threatening the gate-

Media Movers & Shakers

younger execs are charged with articulating a new story of growth to Wall Street, built on disciplined financials, innovative business models, and sales of the most sluggish parts of the old empires. They're managing differently, too, breaking down all the silos the founders assembled so ideas and savings can flow freely. And while there are strong arguments for amassing distribution might, content will always be king. Execs will still struggle to nurture magazines, programs, movies, and music that can stand out in the proliferating clutter.

THE TRANSFORMERS

SO HOW IS this New Media crop coping? Faced with having to push Old Media into fresh forms, Sara Levinson, 54, a top exec at publisher Rodale, hit on a most unlikely combination. She wed the staid, booklet-sized health-and-nutrition magazine *Prevention*, a mainstay from the 1950s, with Microsoft Corp.'s red-hot video-game player Xbox—and she'll soon make a second match with Sony Corp.'s PlayStation. Come again? It's a clever, if far-fetched, play: *Prevention* is offering an interactive fitness video using an animated personal trainer, designed to be played on the big-selling game consoles. So when the kids are at school, moms can get in on some of the fun in those briefly dormant players.

Levinson learned a thing or two about consumers during her time at MTV, where, in the late '80s, she helped turn the cable channel into a culture phenomenon with books, videos, franchise shows such as *Unplugged*, and global outlets. She then moved to the National Football League, creating its first marketing-and-research unit and persuading her male colleagues that reaching the more casual

female fan was a great opportunity. "There are all kinds of consumers," says Levinson, "and you should never look at business with that singular mentality."

Robert A. Bowman, 49, had a similar challenge—taking a well-worn product into new territory. Back in the fall of 2000, when Major League Baseball came calling, he was faced with adapting the 120-year-old game for today's fans. Although in the 1990s he was a suit, serving as president of conglomerate ITT, the Wisconsin native grew up dreaming of playing for his hometown Milwaukee

Brewers. As CEO of Major League Baseball Advanced Media LP, the Wharton MBA decided early on to deliver online and digital services directly to fans, without an intermediary such as Yahoo.

The bet paid off. MLB.com, with revenues of about \$125 million last year, sells 30 services, from live video and audio of full games to fantasy baseball video-games, all available on the Net and on cell phones. Taking a page from Apple Computer Inc.'s iTunes, Bowman last season rolled out a 99¢-per-download video-clip service. "We don't worry about cannibalizing ourselves because even if we lose 10% from one service, we know our customers are still tuned in to baseball and not off downloading a movie or music," he says. That's as good as a save in the bottom of the ninth.

BATTLING PIRATES

BOWMAN doesn't have to worry as much as some execs about the threat of piracy in these new frontiers because most of his offerings are live events. But no media company is immune to the lesson learned by the loss of 30% of music sales in recent years through illegal file-sharing and CD burning. As software and consumer-electronics makers plow ahead in home entertainment, a big push back is inevitable from nervous businesses that still don't feel adequately protected from intellectual-property theft. But four years after the great music massacre, these new execs are also smart enough to realize that to compete with free, you have to offer cool.

So Michele Anthony, 48, executive vice-president at Sony BMG Music Entertainment, stumps on college campuses, hoping to steer students away from stealing music. She grew up in the business: Her dad, Dee Anthony, was a legendary band manager whose acts included Peter Frampton and Joe Cocker. After getting her law degree at the University of Southern California, she represented musicians, too, including Guns N' Roses and Ozzy Osbourne. So Anthony has her own share of street cred when she likens uploading 200 songs illegally to walking out of Tower Records with 15 CDs. She's also pushing a music service backed by the major labels that is offered over campus computer networks. Anthony has signed up 24 colleges for Campus Action Net-

work, but she keeps traveling. "We always compete against free," she says "you can begin to make a difference."

The trick for execs is finding that spot between fighting new technology and pushing into digital delivery. Brandon Burgess, 37, wrestles with every day. The onetime Goldman Sachs Co. banker and mergers-and-acquisitions specialist at PepsiCo Inc. may thought his hardest job so far was he NBC Universal Chairman Robert Wright win the bidding war in 2003 for Vi Universal's TV and movie businesses as executive vice-president for business development and digital media at Universal, Burgess is the front-line for new revenue streams at a company that Wright now declares "platform neutral." Burgess helped in the rollout year of NBC Mobile, which offers phone users two-minute-long video broadcasts. Burgess is also spearheading an internal think tank on new technologies at NBC Universal that will look at offense and defense. "The priority is not just piracy," says Burgess.

SELL IT TO WALL STREET

RUNNING COMPANIES that are out of favor with Wall Street makes the job much harder. Investor skittishness dates back at least to the AOL Time Warner deal. It closed in January, 2001, and since then, the Bloomberg Media index, comprising 36 companies, has fallen 29% and a 5% decline for the Standard & Poor's 500-stock index. To win back investors, execs will need to be financially vigorous and project a more temperate image.

If anybody can sell a fresh story, it's Fred C. Liggins III. He's in broadcasting, a sector some see as mature, slowing ad growth and thinning margins. But Liggins, 40, CEO of Radio One, an African American radio company based in Washington with 69 stations in 15 cities, has a smooth delivery and a big vision for the company his mother, Catherine L. Hughes, founded in 1980.

As a teenager he sold Adidas shoes in Georgetown at a time when Nikes were what people wanted. Today he's hoping to convince the markets that his \$300-million-a-year operation is not a dinosaur but a platform for creating "a University for black folks." He is moving to position Radio One as a multimedia company with a presence in programming, syndication, the Net, and even rival satellite radio. Last year it launched its own TV channel, One, in partnership with Comcast, seen in more than 18 million cable households and aimed at African American households.

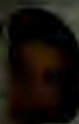
**Rodale's
Levinson is
marrying
Prevention,
which debuted
in the '50s, with
Xboxes and
PlayStations**

25 of Media's Up-And-Comers

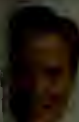
As the industry charges headlong into the digital age, a new crop of executives is moving to the fore. Here are the managers to watch in a number of key posts:

BusinessWeek rated the executives on several crucial skills needed to run a modern media business, with 1 being average and 5 being the strongest

■ OPERATIONS
■ CREATIVE
■ TECHNOLOGY
■ FINANCE

 **MICHELE ANTHONY** 48 (JD, USC)
Chief Operating Officer, Sony/BMG
Onetime lawyer for music acts, now on the front lines of the piracy fight, is the highest-ranking woman in the music biz

5 5 4 3

 **ROBERT BOWMAN** 49 (MBA, Wharton)
CEO, MLB Advanced Media
Former prez of conglomerate ITT is bringing America's pastime into the digital age by offering all kinds of video and audio services

3 2 4 5

 **JOANNE BRADFORD** 41
Chief Media Revenue Officer, Microsoft
A rising star who is remaking online ad biz with universal measurements and helping to script Microsoft's media future

4 2 4 3

 **R. BRANDON BURGESS** 37 (MBA, Wharton)
Exec V-P, Business Development, NBC Universal
Played a big role in sealing merger with Universal; now charting NBC U's digital future by helping to develop wireless services

3 2 5 5

 **STEVE BURKE** 46 (MBA, Harvard)
COO, Comcast
Former Disney exec who helped Brian Roberts build Comcast into a media power; hailed as one of best operators in the biz

5 4 4 4

 **KELLY CONLIN** 44 (MBA, Harvard)
CEO, Primedia
Journalist-turned-exec moving quickly to get niche publisher back on track, first by selling assets such as About.com

4 3 3 4

 **SUSAN DECKER** 42 (MBA, Harvard)
CFO, Yahoo!
Onetime stock analyst using Wall Street sensibilities to help CEO Terry Semel transform Yahoo! into a new media platform

3 2 3 5

 **TERRY DENSON** 39 (JD, Georgetown)
V-P, Video Programming, Verizon
Former cable operator and MTV exec now helping No. 1 phone company compete in video services in its fight with cable

4 5 4 3

 **PATRICIA FILI-KRUSHEL** 51 (MBA, Fordham)
Exec V-P, Administration, Time Warner
Helping CEO Dick Parsons manage 80,000 people and different cultures at Time Warner in wake of the AOL deal. Enough said

4 5 2 2

 **JULIUS GENACHOWSKI** 42 (JD, Harvard)
Chief of Business Operations, Interactive Corp.
Low-key exec who steps up to bring organizational and operating discipline to Barry Diller's e-commerce empire

2 2 3 5

 **SCOTT GREENSTEIN** 45
President, Entertainment & Sports, Sirius Radio
Former movie studio exec helping to put satellite radio on the map by striking one hot programming deal after another

4 5 3 3

 **SARA LEVINSON** 54
President, Women's Group, Rodale
Buoyed MTV and NFL. Now using her varied background in reaching consumers to help publisher Rodale go wide

4 4 3 3



ALFRED LIGGINS III 40 (MBA, Wharton)
CEO, Radio One
Son of company founder who is branching out beyond radio to turn Radio One into a Univision for African Americans

3 4 3 5



SUSAN LYNE 54
CEO, Martha Stewart Omnimedia
Former ABC exec who greenlighted hit *Desperate Housewives*; now helping Martha create new brands after her jail time

3 5 2 3



MICHAEL LYNTON 45 (MBA, Harvard)
CEO, Sony Pictures
Ran AOL Europe and Penguin Group; now bringing his creative and tech experience to the movie biz at the right time

3 5 5 4



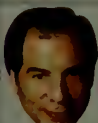
JUDY McGRATH 52
CEO, MTV Networks
If Freston gets the top job at parent Viacom, his longtime lieutenant, who steered MTV from the get-go, could become #2

3 5 3 3



ANN SARNOFF 42 (MBA, Harvard)
COO, WNBA
Former Nickelodeon and VH1 exec is using her marketing and branding expertise to pump up the WNBA and women's sports

4 3 3 4



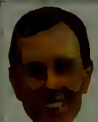
RICHARD SARNOFF 45 (MBA, Harvard)
Executive V-P, Random House
A dealmaker who helped build Random House into the world's largest publisher; now charting new territory in digital media

4 2 4 5



DAN SCHULMAN 46 (MBA, NYU)
CEO, Virgin Mobile USA
Using hip Virgin brand to capture younger wireless customers in a business that looks more media-like every day

5 3 4 4



STEVEN SWARTZ 42
Executive V-P, Hearst Newspapers
A former Page One editor at *The Wall Street Journal* and CEO of *Smart Money* often mentioned as future CEO material

3 5 5 3



ANNE SWEENEY 47
Co-Chair, Media Networks, Walt Disney
Wins plaudits for making the Disney Channel one of the hottest networks on cable; now oversees ABC and all cable operations

4 3 2 3



KATHY VRABECK 41 (MBA, Indiana University)
President, Publishing, Activision
A top-notch marketer in the video-game biz, one of the fastest-growing sectors in media as Hollywood's latest revenue stream

5 5 4 3



DEVIN WENIG 38 (JD, Columbia)
President, Customer Segments, Reuters
Playing a key role in helping to restructure the 153-year-old information business; seen as top-flight CEO material

4 4 4 5



VANESSA WITTMAN 37 (MBA, Virginia)
CFO, Adelphia Communications
Former investment banker who is steering the bankrupt cable operator through its financial debacle to a sale later this year

4 2 4 5



JEFF ZUCKER 39
President, NBC Universal TV Group
Onetime *Today Show* producer with a sharp mind and quick wit; could succeed CEO Bob Wright one day

3 5 3 4

Media Movers & Shakers



MATCHMAKER
Headhunter Citrin
of Spencer Stuart
in Stamford, Conn.

holds. Still, Radio One's share price is off about 25% in the past year. So Liggins the salesman will need to turn up the volume on his pitch to the Street.

Meantime, this new digital world can seem like a Tower of Babel to investors or advertisers used to established rules of trade. Joanne K. Bradford, the 41-year-old chief media revenue officer for Microsoft, is making it her mission to reassure marketers that they're getting their money's worth when they spend online. Coming from a print background (including ad sales at *BusinessWeek*), she adapted some of that industry's auditing traditions to the software maker. Since her arrival in 2001, Bradford has been trying to establish new, standardized measurements for online viewership, a prerequisite if the Net is to become part of major advertisers' standard buys. Besides using the MSN portal as a testing ground, with its 20 million unique visitors a day, Bradford is also sponsoring industrywide studies to help hammer out standards. Her efforts have been likened to what Ted Turner did in the early 1980s to attract advertisers to then-nascent cable TV. "She is just as much an evangelist for online as he was for cable," says Sarah Fay, president of online marketing firm Isobar U.S.

THE CULTURE CZARS

INERTIA IN MANY of the sprawling media empires can make it even tougher to turn a new idea into a revenue stream. Patricia Fili-Krushel faced that problem when Time Warner recruited her, in the wake of the AOL deal, to manage the various workforces and cultures in a company known for its feuding fiefdoms. Walls needed to be crashed, especially at a com-

pany of 80,000 employees—roughly the population of Canton, Ohio. "The first thing I learned is, you have to manage in teams in this new world," says Fili-Krushel, 51. The former ABC executive now organizes regular bimonthly meetings with CEO Richard D. Parsons and the company's nine division CEOs and six executive vice-presidents.

It's a similar picture at cable giant Comcast, with 68,000 employees. When Chief Operating Officer Stephen B. Burke, 46, took the job with what was then a midsize cable operator in 1998, industry pundits were shocked—Burke had been a golden boy at Disney. In a dozen years he had overseen the retail stores, Euro Disney, and ABC's TV and radio stations. At Comcast he's No. 2 to 45-year-old CEO Brian L. Roberts, helping to build the company into the nation's largest cable outfit, with 21 million subscribers and new power in the media world. Among Burke's latest feats: integrating ahead of schedule the AT&T Broadband cable systems Comcast acquired in 2002.

With Roberts, he's also the architect of Comcast's maze of relationships involving collaboration among fierce rivals, arrangements that typify this new age. Consider Comcast's ties to two of the biggest media companies. With Time Warner, Comcast negotiates prices for programming. The two are also partners in a new New York Mets sports channel. Both are bidding to buy and split up Adelphia Communication's cable assets. Then

again, it was Comcast's 11th-hour agreement to partner with Sony last fall helped seal the Sony/MGM merger, all ending Time Warner's chances as a bidder. News Corp., meanwhile, is a big supplier of programming even as its satellite service, DirecTV Group Inc., is a direct rival in distribution. "Listen, with all you realize life is long," says Burke, "you get along well because of that."

THE TALENT SEEKERS

WILL HAVING MORE professional managers running things snuff out the creative sparks that power these hit-driven enterprises? After all, as entertainment choices proliferate, offering entertainment that actually entertains is more critical than ever. Even at a time when shows and movies are branded like drinks to generate new revenues, finding and backing a hit is still about instinct and luck. "It's not like selling cereal in Indonesia," says Time Warner's Bewkes, who won high marks for his support of creative types when he ran HBO. "It's more like drilling six holes for oil."

The bets are getting even bigger. At Sirius Satellite Radio Inc., execs have poured up more than \$850 million for programming deals over the past year in a still-proven business. Making these big-movements is President for Entertainment Sports Scott Greenstein, 45, a former chief of movie studio USA Films, known for Oscar-winning movie *Traffic*. To differentiate

Teaming with rivals in some areas while competing in others typifies this new age

Sirius' 100-plus channels, Greenstein's strategy is to supplement dozens of commercial-free music channels with headline-grabbing talent from other channels that would draw big advertisers like Oprah Winfrey and former President Bill Clinton on his wish list. News Corp. signed shock jock Howard Stern is sure to lure new subscribers starting

2006, but Greenstein, who also worked at Miramax Film Corp., wants to avoid turning Sirius into the Howard Stern network.

As president and CEO of Martha Stewart Living Omnimedia Inc. (MSO), Susan Lyne knows full well the perils of relying on one personality to make your brand. The 54-year-old ex-ABC exec also has an eye for talent, having championed the network's current hits *Lost* and *Desperate Housewives* before leaving under pressure last April. She's hoping to stir up new interest in Stewart's iconic celebrity and play off the publicity from the domes-



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Media Movers & Shakers

diva's release from prison. But Lyne is also trying to speed up development of secondary brands, such as *Everyday Food*, which now has monthly publication as well as a weekly TV series on PBS.

By its nature there's really no escaping the new world of media. Comcast's Burke is bombarded every night when he walks through the door of his suburban Philadelphia home. There, his five kids,

ages 8 to 16, are instant messaging, cellphoning, listening to MP3 players, playing video games, and watching video-on-demand—often all at once. “Our kids have become our canaries in the coal mine,” he says. Nor is the pace of media about to let up anytime soon. And while nobody would be surprised if the still-spry Rupert and Sumner were running their empires as centenarians, the de-

mands of the new age are quickly moving the media biz into new hands. ■

—With Ronald Grover in Los Angeles
Catherine Yang in Washington
and Diane Brady in New York
Stephen Baker in New York

BusinessWeek online Top headhunter Jim Citrin offers his advice to media's up-and-comers at www.businessweek.com/extras

MEDIA ELITE

Great-Uncle Dave Would Be Proud

Power couples in the media world are nothing new, but among the new generation of media leaders the pairing of Richard and Ann Sarnoff has a unique old-generation pedigree. Richard's great-uncle was former RCA Chairman David Sarnoff, who pioneered the development of the first commercial radio station and became known as one of the architects of mass media. The Sarnoffs met in the fall of 1985 at Harvard Business School and today are helping to shape the future of publishing and bolster fledgling women's professional sports: he as an executive vice-president of Random House and she as the chief operating officer of the Women's National Basketball Assn.

In mostly a dealmaking and financial role at Random House, a unit of German media giant Bertelsmann, Richard, 45, has worked closely over the past decade with Chief Executive Peter W. Olson to help build the book publisher into a \$2 billion-a-year business. He's also the only American executive at the company serving on Bertelsmann's supervisory board, one of its two key governing bodies. Among his priorities is pushing the publisher into the digital arena: His latest deal on Feb. 17 involved Random House Ventures, a tech investment unit, buying a minority stake in wireless-content distributor VOCAL.

Richard says he often thinks about his great-uncle's work in creating NBC, the first broadcast network to reach across the entire country. “Uncle Dave” would probably see today's media world “as an interesting return to the beginnings of electronic media,” says Richard, who remembers being awestruck visiting his great-uncle's tech-equipped Manhattan townhouse in the 1960s and seeing a painting slide back to reveal a TV

set. And wireless broadband? “The first application of wireless transmission was point-to-point, ship-to-shore, rather than broadcast [He] might look at this narrowcasting phenomenon and think ship-to-shore is coming back.”

As Richard advanced on the financial front, Ann, 42, moved up in marketing. At Nickelodeon, she was instrumental in the rollout of the hot-selling *Rugrats* and *Blue's Clues* merchandise and was later elevated to COO for sister units VH1 and Country Music Television, the first woman in that role at Viacom's MTV Networks. Now at the WNBA, where she oversees advertising, marketing, broadcasting, and merchandising, Ann says “it's a job and a cause.” She was brought in a year ago to help breathe new life into the eight-year-old league, which has struggled

with tepid TV ratings and building a larger fan following. Says NBA Commissioner David Stern: “We needed somebody with broad executive skills but also [who knew] consumer goods and brand management. We got her.”

Having both husband and wife working in the insular media business in New York is sometimes tricky. Random House, for example, became a Nickelodeon licensee when Ann was there. Ann is also one of the subjects in a book Random House will be publishing, *Ending the Cat Fight*, about mothers who choose to work vs. those who don't. Richard says they just don't discuss negotiations on any of those deals. So is there competition between the two ambitious execs? “How could there not be? But it's healthy, and ultimately we know we are in each other's corner,” says Richard.

The top priority, they say, is their 13-year-old daughter and 9-year-old son. When Ann travels, Richard is at home—and vice versa. They want their kids to take an interest in what they do. And they want them to recognize that when they turn on TV or radio or even boot up their PCs, the Sarnoff legacy is part of how it all came to be.

—By Tom Lowry in New York



THE SARNOFFS AT HOME Ann is the marketing maven, Richard is the dealmaker



The 7 WONDERS of TARGETED ADVERTISING

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Jane Mervar pictured with daughter Karli



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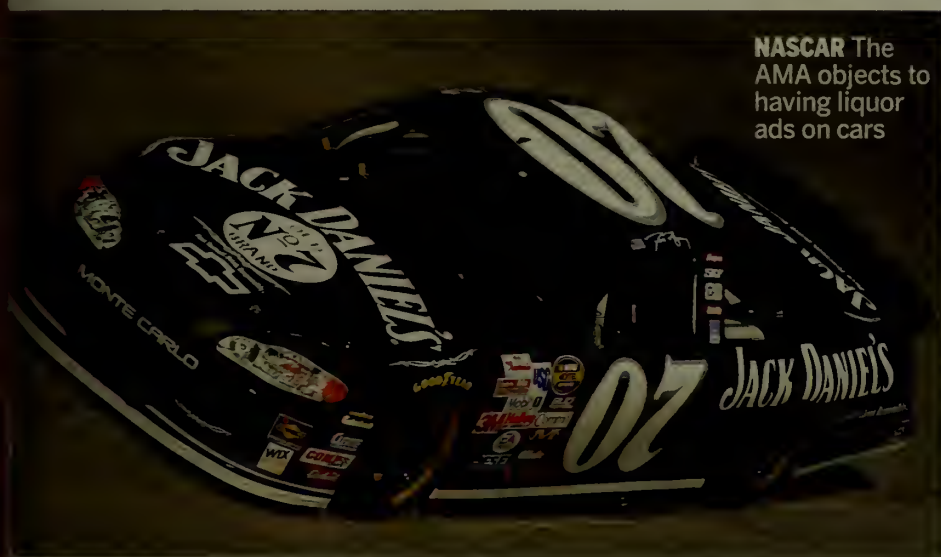
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A Green Flag For Booze

As marketing barriers fall, ad budgets aimed at cable and local TV are soaring



WHEN NASCAR driver Kurt Busch roared across the finish line in his Ford during the Budweiser Shootout on Feb. 10, last year's NASCAR champ finished a disappointing sixth. But Diageo, whose Crown Royal Canadian Whiskey logo was plastered across the hood of Busch's Ford Monte Carlo race car, scored a huge win. It was the first time in NASCAR's 56-year history that a liquor logo was displayed on a car. NASCAR's decision to lift its long-standing ban on liquor sponsorships this season is the latest marketing barrier the industry has managed to break through. More than 600 local broadcast stations recently accepted booze ads last year—up from only 60 in 2002. Sure, network TV still prohibits liquor spots, but cable and local broadcast stations carried more than \$100 million worth of them last year. Even NBC is planning to jump in with liquor ads this year. Add that to the industry's re-

cent victories in getting nearly half the states to permit tasting events in liquor stores and a rising number to drop laws forbidding sales on Sunday.

The rash of advertising is fueling a boom in sales. Total U.S. liquor sales last year were \$14.7 billion, up 12% from two years ago, while total cases sold were up 7% in two years, to 164 million. It's the first time case sales have been up more than 3% in two consecutive years since the 1980s. Meanwhile, the industry is trying to position itself for a surge in the number of consumers who will turn 21 over the next decade.

Because liquor companies have long had advertising restrictions, they have always spent big on public relations and event marketing. But now ad budgets are fattening, too, to take advantage of new opportunities on TV. Diageo

spent \$150 million just on ads last year, up almost 30% from a few years ago—and TV is the big driver. The marketer of Crown Royal, Johnnie Walker, and José Cuervo spent half its budget last year on TV. Brown-Forman Corp. spent \$27 million last year on Jack Daniel's alone. A third of that was on TV. Absolut, Southern Comfort, Bailey's Irish Cream, and Bacardi Rum hit TV, too, totaling more than \$100 million last year, and many analysts say that could double in the next three years.

NO CARTOON CHARACTERS

STILL, THE NATIONAL broadcast networks expect to sit out the surge, maintaining their self-imposed ban. NBC tried in late 2002 to run liquor ads in late-night time slots to test the water. It got slapped down by public pressure. "The reality is that broadcast networks are held to a higher standard," says Alan Wurtzel, head of NBC Standards.

Even with most barriers collapsing, liquor companies are treading cautiously. All the ads connected to NASCAR have a strong responsible-drinking component. Jack Daniel's, a first-time NASCAR sponsor this year, has a TV spot that features its NASCAR car and the slogan "Pace yourself. Especially when you're drinking." Having learned from tobacco's woes and eager to distance themselves from beer spots, liquor companies aren't featuring animals or cartoon characters.

Initially, NASCAR officials were skeptical about lifting its ban. Diageo, Brown-Forman, and Jim Beam Brands started lobbying the racing league in the late '90s, seeing sponsorship as not only a good audience fit but a big symbolic step into the mainstream. "NASCAR and its fans are as representative of the country as you can

get," says Guy Smith, Diageo's executive vice-president for North America.

But even as strictures loosen, putting booze ads more on par with beer and wine, critics aren't ready to give in. The American Medical Assn. has an active campaign against NASCAR sponsorships and TV ads and says one of the fastest-growing pieces of NASCAR's audience is 12- to 18-year-olds. "Advertising liquor on the actual race

cars that youth idolize sends the wrong message," says AMA President Dr. J. Edward Hill. Right or wrong, the message is a lot easier to get out. ■

—By David Kiley in New York

THE STAT

600+

The number of local broadcast TV stations carrying liquor ads last year—up from 60 in 2002.

Data: Distilled Spirits Council

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ASP: Managing Productivity in the VoIP Convergent Enterprise

Productivity is the name of the game in today's fast paced business world. Employees and managers who are able to effectively measure the use of their time are then able to plan and produce results most efficiently. Call management plays a key role in people's time management with increasing importance. Long-distance costs have dropped dramatically in recent years while salaries have increased. *An employee's time in cents per minute is now 10X to 20X higher than the cost of phone calls!*

Increased focus on productivity includes considerations for web-based services to further

reduce operational costs. As enterprise PBX networks evolve from traditional TDM services to VoIP services, this scope becomes more complex requiring comprehensive and automated management tools that do not increase the burden on IT Departments.

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Leveraging Information Across Your Enterprise

Information Access: The Challenge - Like many businesses today, construction companies face significant challenges in accessing and managing their financial information across varied systems and locations. Such firms are inherently decentralized with a complex mix of field-based project management and corporate accounting staff that often utilize separate software applications for tracking project and financial data. These disparate systems limit any comprehensive real-time view of information. This can result in costly errors, re-keying of data, system reconciliation and data integrity issues—not to mention the expense of maintaining multiple applications. Solving this

dilemma would streamline operations and provide consolidated information that accurately reflects the current state of business. To achieve this, construction firms must effectively manage financial information across remote sites and users, and respond to that information rapidly.

Integrated Systems: The Key - A fully integrated system allows for data sharing across locations and users from a central database. By utilizing a single application, data is entered once, updated in real-time and re-used for multiple purposes. This eliminates input repetitions, problems with accuracy and timeliness, and the need to reconcile data from multiple systems.

Integrated systems also support immediate and concise information that generates improved reports for better informed users, and an increased awareness of project and budget status. Project management and accounting staffs can share vital data enabling them to produce comprehensive reports and arrive at more effective financial and forecasting decisions.

Web-based Access: Keep It Simple - Web-based systems provide the most efficient method for connecting remote users via a web-browser. These systems increase speed and accessibility, lower complexity, and link remote locations real-time. Web-based applications allow for the creation of integrated project-specific web sites that can be used for collaboration with remote sites and business partners, increasing efficiencies and improving communication.

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Key Components of a Database Marketing System

design, structure and maintenance of a relational Database Marketing System ("DMS") is the first step for direct marketing success. It is the central repository of customer promotion history and response data. Its primary purpose is to improve the overall effectiveness of a company's direct marketing customer acquisition and retention strategies. A successful DMS requires four key components: quality, business relevance, accessibility/easy integration, and multi-channel privacy compliance. First, a DMS is only as good as the data it contains. Data quality is the core foundation of any relational database. Initial file hygiene optimizes address integrity.

All data feeds must be routinely checked for accuracy, cleanliness, and de-duplication. The application of Persistent IDs, the key which links and aggregates multiple sources of individual, household and business level detail from multiple channels is also necessary. These "investments" set the stage for actionable information from which business decisions are made.

Secondly, a DMS must be designed entirely around the business it supports. A detailed and well-documented DMS design plan will define the marketing goals necessary to advance a business forward. A DMS must also be integrated into legacy systems and all data sources, while maintaining its primary marketing focus.

Thirdly, a DMS must be readily accessible, easy to use, and support full marketing functionality. An effective DMS toolset includes the following tools: Query, Reporting & Business Intelligences, Analysis/Predictive Modeling, and Campaign Management.

Finally, a DMS must be intelligent and responsive to the challenges of multi-channel marketing in an increasingly privacy protected society. The system must enable marketers to identify and contact clients and prospects according to their changing privacy & channel preferences.

A DMS is no longer a business's high-end tool for customer data storage. It is the business, the nerve center identifying the best touch points to engage with prospects and customers.

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Backup – Your Last Line of Defense

A decade ago, IT organizations put in place backup plans in order to restore data from hardware problems, or in the rare case, a physical disaster. Today, the need for a sound data protection methodology is even more important because hardware failure is no longer the most common scenario. The most common reason for restoring data is due to logical corruption, specifically, computer viruses and/or application failure.

In order to restore from logical corruption, you must be able to do two things. One is the ability to go back in time for the data in

order to get an uncorrupted copy of the data. This can be accomplished with frequent backup-to-disk or data "snapshot" methodologies. The second is to have data offline as well as online. If all your data is online, it is susceptible to corruption from viruses. With offline removable tape media, you can be assured that data on those backups cannot become infected.

With the prevalence of viruses that attack the operating system itself, the availability and stability of web and application servers is at risk. The best way to mitigate any extended

server downtime is to have an "offline" copy of the server image that can be used to restore the server operating system (OS) in order to bring the server up and restart business critical applications. The process of restoring a server from "scratch" is referred to as Bare Metal Disaster Recovery. This allows you to re-boot the system from a CD/DVD/Tape and lay down the OS the way it existed before the corruption.

A sound backup strategy of frequent backups to disk, combined with offline tape backups and Bare Metal DR ensures that you can recover from almost any logical corruption of your business critical data.

To read the full report go to
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Progressive Ideas and Leading Technologies

Commoditized Banking Creates Market Efficiency, Customer Value

In the U.S., people no longer think about where to get cash, how a deposit is routed to their bank, or whether the bank is open when they're ready to pay bills. Banking services have become ubiquitous, available through a wide variety of distribution channels on demand. By now, you would expect the market for financial services to be operating efficiently.

But it's not. Basic banking services are the same across the industry, but each financial institution continues to invest heavily in maintaining proprietary systems and interfaces to support these basic functions. Everything a bank typically

offers, from opening a checking account to processing a mortgage to operating an ATM is often dependent upon highly customized software programs and an expensive, complex infrastructure.

Yet the requirements to support a checking account, for example, are the same no matter who performs the task. This industry-wide consistency supports the commoditization of banking services, but the market remains inefficient because institutions are internally focused. Big banks understand the need for enterprise-wide integration of their own business to achieve operating efficiencies and customer benefits, but they must

apply that same thinking to leverage a place through the formation of banking utility.

The bank utility model will open up the chain to more vendor competition and economies of scale opportunities through the use of standardized technology. Banks will be able to leverage the investments they now make in proprietary technology and infrastructure and re-direct them to create a better customer experience for their clients and a higher return for shareholders.

The technology to commoditize basic banking services is available right now, and the economies of scale benefits are a powerful incentive for banks. With a clear roadmap and the vision of industry implementers, the banking utility model will become a welcome reality.

To read the full report, go to www.technology-reports.com/fin/050101



Fidelity Information Services provides information processing management, outsourcing, professional consulting and integration software to the financial services industry. As a strategic partner, Fidelity offers over 40 years of experience as a leader in the industry focused on enabling the long-term success of its clients. Forty-six of the top 50 U.S. banks and 24 of the top 50 global financial services organizations rely on Fidelity. Jacksonville, FL * 800.874.7359 * www.fidelityinfoservices.com

Retailers Grow Profits with Business Intelligence Software

In retail, profit margins are historically thin and competitive pressures are always severe. Every day, executives search for ways to drive costs out of the business and push margins higher. That's why companies such as Albertsons, SUPERVALU, OSCO Drug, Ahold USA, and dozens of other supermarket, convenience and drug store companies use business intelligence (BI) software combined with smarter store practices to improve sales, margins, and customer satisfaction.

Growing profit in retail demands three components: faster and smarter decision-making, clear accountability for teamwork to achieve profitability

goals, and a process that merges immediately useable decision-support information and best practices for the people responsible to use that information.

Here's what current business intelligence users say, "Using BI to interpret masses of data and alert us to abnormalities we would have never uncovered has dramatically improved many of our systems." "BI software gives us new competitive advantage." "The average return on our investment was under 16 weeks, following a brief six-week set-up and data analysis period." "Clearly, using smart technology has made our managers

smarter and earned more profit." "It's improved both our profit and our customer service."

With same-store retail sales limited to less than 2.0% in most retail verticals, store shrinkage rising higher than 2.5%, and employee turnover at 60%, retailers are turning to experts in retail business intelligence to measurably improve sales, margins and meet SOX corporate governance compliance monitoring requirements. Properly positioned and managed, advanced intelligence tools and smarter management practices can drive profit margins up to 38% in less than 16-24 weeks.

BI software and related management best practices are transforming the way many retailers use the information they now have

To read the full report, go to www.technology-reports.com/retail/050101

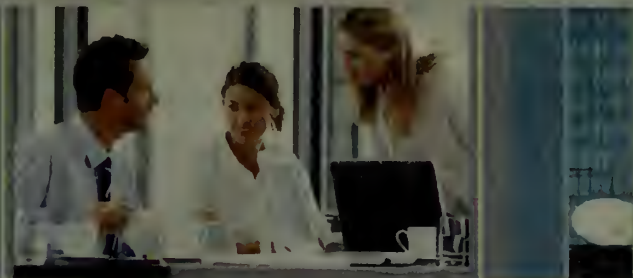


Trax Retail Solutions, Scottsdale, Arizona, is a leading provider of business intelligence software for retailers. Its team of over 50 operations and loss prevention professionals teaches companies and managers to employ smart technology and smarter store management practices to grow profit in the highly competitive retail market. Trax develops and sells its SmartStore suite worldwide through direct and dealer channels. Contact: Trax Retail Solutions at www.traxretail.com or info@traxretail.com or (800) 469-1070.

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Eliminate Costly Compliance Violations through Outsourcing

complicated compliance regulations, like the Fair Labor Standards Act, placing staggering demands on corporate compliance today, companies are putting greater emphasis than ever before on responding to these demands. Left unaddressed, violation of workplace regulations can cost U.S. organizations millions of dollars each year. For example, in 2003 more than \$182 million in back wages were recovered for violations to which one car rental company paying close to \$1 million to settle a class action lawsuit. To ease the burden of concerns, many companies are turning to outsourcing their HR and payroll functions to help

substantiate their controls and accurately record and produce compliance documents quickly and easily.

These records can track employee information regarding hiring, training, promotion, transfer, and/or termination. Reports can be prepared and run on individual locations, by federal employer identification numbers, or by component companies. To reduce corporate vulnerability to FLSA violations, for instance, payroll history records should remain available on demand for the required three years.

With outsourcing, corporations whose core business is not technology can stop supporting server hardware and no longer deal with installing

product upgrades. The outsourcer undertakes all updates and new releases. Companies know that their data is safe because the solution is hosted at a secure, state-of-the-art facility. Businesses gain the power to control their processes and functions on their own schedules, with predictable monthly pricing, lower upfront costs, and no additional, expensive hardware purchases.

With legislative compliance issues becoming more burdensome each year, corporations must look to technology to help them track governmental regulations. Outsourcing HR and payroll processes is the first step corporations should take to stay out of the hot seat and on top of legislative compliance risks.

To read the full report, go to
www.technology-reports.com/ultimate.asp

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benefits enrollment, built-in workflow, and recruitment. Managers can analyze workforce statistics on demand, and employees have Web-based self-service.

Ultimate Software, a leading provider of Web-based payroll and workforce management solutions, provides midsize and large companies with HR/payroll outsourcing services through Intersourcing, a hosted offering of its UltiPro Workforce Management software. UltiPro has strong reporting, including business analytics, as well as a Web portal, tax compliance, and employee self-service.

Summing Up Systems for Compliance and Litigation Readiness.

Corporate IT departments are rapidly moving toward full-scale adoption of digital archiving methods to underscore compliance with the Fair Labor Standards Act and other recent corporate governance measures. Storing records in digital archives makes information far more accessible for corporate personnel. Ironically, the increased accessibility of information residing in corporate content or enterprise records management archives makes it a high-profile target of outside parties, eager to use such information at the corporation. Full response to regulatory or discovery requests while protecting the

company's best interests can be onerous, disruptive and extremely expensive.

The good news is that systems are available that can be used in conjunction with digital archives to significantly streamline the information gathering and review process. By linking litigation support systems to the enterprise's various data stores, corporate legal departments can:

- tap into or receive corporate content for a parsing review that defines responsive and relevant information
- deliver circumscribed subsets of information to outside counsel for further review

• monitor and collaborate with outside counsel at the document level

• allow flexible application of the best means to review, convert, collaborate, and produce regulatory or discovery response content to meet the specific needs of the matter at hand.

By implementing litigation support systems that work in concert with archival infobases, corporations can reap appreciable savings through reduced outside counsel and outside information processing service fees and costs. The state of readiness made possible by such a unified system can also garner the corporation great strategic advantages.

To read the full report, go to
www.technology-reports.com/summation.asp

Summation Legal Technologies, Inc., a subsidiary of CT Corporation (a Wolters Kluwer company), pioneered PC-based integrated litigation support software in 1988. The company's products are now in use by over 50,000 litigation professionals worldwide. The company's latest release, Summation SSE, allows corporate counsel to review data gathered from its various data archives and seamlessly share case information with outside counsel, all with a common interface. San Francisco, CA 800-735-7866 www.summation.com.



SOFTWARE SOLUTIONS 2005

Progressive Ideas and Leading Technologies

Pricing Analytics Software Opens Hidden Door to Increased Profits

Few investment opportunities rival the track record of pricing analytics software, shown to increase profits by 50% or more. Most companies don't realize how much money they are leaving on the table because they don't have the tools to understand what their data is telling them. Although companies generally store a significant amount of data, most do not yet have specialized tools to analyze the data in a meaningful way, especially to support educated pricing decisions.

Pricing analytics helps companies better understand how each pricing decision affects the company's profits. Without this understanding, compa-

nies find themselves operating in the dark, while valuable profit dollars leak out of sales transactions and missed opportunities. When it comes to pricing decisions, employees tend to operate in comfort zones, making pricing decisions based on experience-based "gut feel" or intuition. Unfortunately, these comfort zones often cost companies large amounts of unrealized profits.

Pricing analytics gives managers visibility to unnecessary discounting and to missed sales opportunities when prices are too high. The software constantly monitors sales, inventory, cost, and market data to alert managers when market

conditions have changed, and pricing action is necessary. Built-in analytics can help managers anticipate the outcomes of specific price changes so they can make decisions that support the company's revenue and profit objectives.

Pricing systems utilize data that is collected from existing data systems, including: CRM, ERP, and Warehouses. Therefore, most companies already have the foundation for pricing analytics – they just need the tools to unlock the power of pricing.

In today's market, increasingly more companies are adopting pricing analytics technology. Published studies have attributed profit increases of 25-50% more from the implementation of these systems in many industries, pricing analytics systems have proven to give a decisive competitive advantage.

To read the full report, go to
www.technology-reports.com/PROS

PROS PRICING SOLUTIONS

PROS is the world leader in Pricing Analytics and Optimization software solutions, having implemented over 250 software solutions across 13 major industries. PROS software helps Fortune 1000 companies forecast demand, model elasticity, and monitor transaction profitability. PROS' clients have attributed profit increases of 25-50% to the application of PROS Pricing Analytics Optimization technology. PROS also hosts an annual Pricing Excellence Summit May 1-3, 2005. Visit www.prospricing.com, email info@prospricing.com, or call 713-335

Business Intelligence Helps Companies Make More Profitable Decisions

Good decision-making drives revenues, controls costs and improves productivity for an organization. Yet some people make better decisions than others. Companies are challenged to make the most of their team while boosting performance to optimal levels.

While information influences quality decision-making, how a decision-maker uses the data is the key to making more profitable decisions. Research has shown that the best decision-makers make better decisions when they have learned all of the key variables and know how to apply the appropriate methods for a given situation. Once they have learned these critical influencers, top performers consistently make better

decisions. So, what if everyone in an organization was able to perform as well as the top decision-makers?

Today, emerging technology is able to uncover the critical drivers of the decision-making process and map data situations to best practice results. This new Business Intelligence (BI) software learns from the decisions made by the company's top performers and recommends decisions similar to what the experts would do. The software provides needed intelligence to help companies significantly improve the productivity and quality of critical business decisions. As a result, they can quickly realize lower operational costs, improved productivity and higher profitability.

In retail merchandising, for example, BI technology is helping to identify outside influencers, determine buying patterns and critical relationships that the best allocation managers use to ship products to stores. Software such as AIS' Allocation Intelligence introduces an added level of intelligence giving managers the ability to leverage the knowledge and experience of their best allocation managers, driving significantly higher sales while minimizing markdowns.

BI software allows businesses to identify knowledge that drives complex decisions and to recognize actual "best-practice" decisions of top performers. As a result, organizations can capture best practices and methods to continually improve on decision-making, reduce complete reliance on top trained professionals and drive higher profits overall.

To read the full report, go to
www.technology-reports.com/AIS.asp



Applied Intelligence Solutions, LLC (AIS) offers business intelligence solutions that replicate expert human decisions, providing the ability to automate and significantly improve the quality of decisions across their organizations. Improving decision quality yields significant improvements in top-line revenue, bottom-line profit and employee productivity. AIS is headquartered in Boulder, Colorado with Research and Development facilities in Moscow, Russia. For more information visit the company's web site at www.aisllc.com

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Revenue Agencies: Doing More with Less

Government revenue agencies are using a number of strategies to meet the challenge of improving services they provide despite increased workloads and reduced staffing levels.

Examining business practices

Agencies are streamlining business processes, eliminating unnecessary activities, and automating less functions. Using technologies such as 2D scanning, imaging, and predictive dialers, agencies are finding ways to do more with less.

Integrating tax programs and functions

Computer systems that consolidate functions into a single integrated solution are gaining favor. The resulting

comprehensive view of the taxpayer across all tax types and business functions enables better taxpayer service and reveals opportunities to improve compliance.

Moving to state-of-the-art solutions

The transition is well underway from mainframes of the 1970s and '80s to mature and robust micro-computer based platforms, resulting in significant gains in ease-of-use, compatibility, and functionality while reducing infrastructure costs.

Providing electronic services

Services such as on-line registration, e-filing, interactive voice response, and self-service websites are enhancing taxpayer service while reducing

work for agency staff.

Identifying non-compliance

Combining data from an integrated system with multiple external data sources and using intelligent matching tools, agencies are identifying under-reporters and non-filers and taking steps to bring them into compliance.

Focusing on tax administration

Frustrated with the resource commitment required to develop and maintain custom-built systems, agencies are moving towards commercial off-the-shelf (COTS) software.

Citizens and elected officials will continue to demand more services at a lower cost from government. To meet this challenge, revenue agencies are finding new and creative ways to use technology.

To read the full report, go to
www.technology-reports.com/FAST.asp

FAST
ENTERPRISES

Fast Enterprises, LLC specializes in providing software products and IT services to government revenue agencies. FAST's core product, GenTax®, is the world's first Commercial Off-The-Shelf (COTS) integrated tax processing solution. To learn more call 1-877-275-3278, or visit www.gentax.com.

Beyond E-mail: Life-Cycle Sales and Trends in Digital Direct Marketing

Recent years have seen a decline in traditional advertising and a move toward technology-enabled marketing channels that allow for greater reach, more customer interactivity, and more measurability for producing ROI. Aberdeen Group and other industry analysts are calling this industry 'digital direct marketing.'

The dot.com rush was reaching its crescendo, and waves of digital direct marketing exploded in the late 90s in the form of keyword-targeted banners appearing at major search engines. The trend soon wore off, however, as banner ads saturated the market, and Overture (then called GoTo)

upped the ante by introducing the radical concept of selling search result placements. While not as visually interesting as banner ads, paid search placements caught on quickly, and Google joined the fray with its tremendously successful sponsored links and dynamically priced advertiser links called AdWords and AdSense. Also by that time, e-mail marketing had made its earnest debut among brand-name retailers as a legitimate and effective direct marketing channel.

As the marketing industry and its array of technology suppliers continue to resolve shortcomings and fine-tune the effectiveness of banner ads,

search placements and e-mail blasts, the next trend in digital direct marketing will be to push technologies beyond customer prospecting and deeper into customer acquisition, fulfillment and retention. Because of this, digital direct marketing will permeate all stages of the customer life cycle.

Ironically, the trend toward digital direct marketing spells the end of e-mail as a digital marketing channel since other technologies better suited for interactive marketing are currently being adopted. This change will happen because e-mail marketing is stuck in a 'batch-and-blast' mode of one-way communications, while the direct marketing industry is compelled to move toward supporting a customer throughout a life-cycle of transactions.

To read the full report, go to
www.technology-reports.com/direct.asp

ATALODE INC.

DataLode, a provider of marketing automation solutions, has developed a technology called RealConnect™ to establish and maintain permissioned and actionable one-to-one relationships between enterprises and their customers. RealConnect was developed in response to industry demands for solutions to automate the marketing communications process and break through the clutter of traditional marketing channels, thereby lowering the cost of customer interactions and reducing campaign implementation timelines. DataLode San Rafael, CA 877.556.7700 www.DataLode.com



States' Rights Vs. Free Trade

As trade pacts proliferate, states start to howl about lost sovereignty

THE GOOD PEOPLE OF Utah decided 110 years ago that gambling was one vice the state didn't need. So they outlawed it and later added electronic gaming to the ban. Now, Utah's right to make games of chance illegal has been shot down by the World Trade Organization.

WTO judges ruled last fall in a case brought by the government of Antigua and Barbuda that gambling regulations in Utah and most other states conflict with America's obligation not to discriminate against foreigners providing "recre-

ational services." In ruling for the tiny Caribbean nation, which had charged that Utah's wager-phobia infringed on Internet gambling operations based in the islands, the WTO opened the door to millions of dollars in potential penalties. "It's not just gambling," warns Utah state representative Sheryl L. Allen, a Republican who chairs a multistate committee studying free-trade deals. "The states are losing their authority in a lot of areas."

After decades of dozing on the sidelines as Washington promoted a free-trade agenda around the globe, governors, state lawmakers, and judges are waking up to the same startling reality: A

IN EL SALVADOR
Some states may oppose a trade deal with Central America

growing number of international trade agreements are usurping state powers. Suddenly

alarmed that Washington is bargaining away their authority over everything from regulating utilities to controlling land use, states are all but ready to join the chorus of anti-globalization critics.

ERODING SUPPORT

THE STATEHOUSE uprising against trade deals comes at a bad time for President George W. Bush's trade policy. This summer, Congress will debate the Central American Free Trade Agreement (CAFTA) between the U.S., the Dominican Republic and five Central American nations. It will also consider whether to end U.S. membership in the WTO and extend Presidential authority to negotiate future deals.

Business groups worry that an outside-the-Beltway rebellion will overwhelm Congress's razor-thin support for trade deals. The National Conference of State Legislatures, for example, may withdraw its longtime support for so-called fast-track authority.

Such concerns from the heartland are already stiffening the anti-globalization sentiments of those conservative Republicans who view the WTO as an attempt to impose a one-world government. Elements of the Right and the Left increasingly agree that modern trade deals mostly serve the interests of multinational firms intent on moving investment and jobs offshore.

CAFTA is the most likely victim of rising resistance. But Corporate America fears that objections from the states could also undermine its hopes of reaching the Holy Grail: reducing barriers in developing nations to trade in services. Talks for the 148-nation WTO that would center trade in services are already a year behind schedule. J. Robert Vastine, president of the Coalition of Service Industries, fears among the states are "wildly exaggerated by people who want to make free trade out to be the devil." But, he concedes, "we are going to need a more carefully thought-out approach to deal with these concerns in the state capitals."

That won't be easy. The assault on sovereignty is rooted in a series of trade agreements stretching back to the mid-1990s. The 1994 North American Free Trade Agreement and the pact creating the WTO in 1995 both established trade judge panels that can authorize punitive tariffs or fines against violators. The judges put teeth behind vaguely worded

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Investors should note: *Current performance may be lower or higher than the quoted past performance, which cannot guarantee future results. Share price, principal value, and return will vary, and you may have a gain or loss when you sell your shares. Request a prospectus or a briefer profile; each includes investment objectives, risks, fees, expenses, and other information that you should read and consider carefully before investing.* The fund is subject to stock market volatility.

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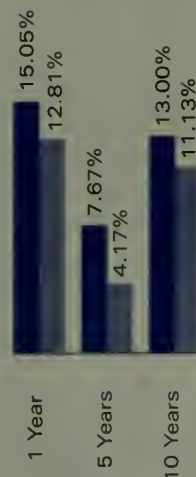
★★★★

The fund was rated among 781, 781, 559, and 244 large value funds for the overall and the 3-, 5-, and 10-year periods ended 12/31/04, respectively.**

Performance Versus Competitors

Average annual total returns as of 12/31/04

■ Equity Income Fund
■ Lipper Equity Income Funds Average



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Average annual total return figures include changes in principal value, reinvested dividends, and capital gain distributions. *Lipper also ranked the fund #53 out of 237, #20 out of 134, and #8 out of 62 equity income funds for the 1-, 5-, and 10-year periods ended 12/31/04, respectively. **For funds with at least a 3-year history, a Morningstar Rating™ is based on a risk-adjusted return measure (including the effects of sales charges, loads, and redemption fees) with emphasis on downward variations and consistent performance. The top 10% of funds in each category receive 5 stars, the next 22.5% 4 stars, the next 35% 3 stars, the next 22.5% 2 stars, and the bottom 10% 1 star. Each share class is counted as a fraction of one fund within this scale and rated separately. The Overall Morningstar Rating™ is derived from a weighted average of the performance figures associated with a fund's 3-, 5-, and 10-year (if applicable) Morningstar Ratings™ metrics. Morningstar Rating™ is for the retail share class only; other classes may have different performance characteristics. The fund received 4 stars for the 3-, 5-, and 10-year periods. T. Rowe Price Investment Services, Inc., Distributor.

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Government Trade

commitments—buried in hundreds of pages of arcane detail—that nations will use the “least trade-restrictive” regulations and laws “no more burdensome than necessary” to accomplish their social, economic, and environmental goals. The unintended result: “These agreements are not just about trade anymore,” says Lori Wallach, a trade-law expert at consumer watchdog Public Citizen. “They’re about every aspect of government.”

Just ask California Governor Arnold Schwarzenegger. In December the governor’s advisers warned that proposed tax incentives meant to encourage road builders to grind up California’s annual harvest of 32 million

used tires and blend them with asphalt would violate NAFTA by putting Canadian and Mexican recyclers at a disadvantage. Schwarzenegger vetoed the bill.

The next front could be a battle over state contracting rules. In 2003, U.S. Trade Representative Robert B. Zoellick won backing for CAFTA from 22 governors, who pledged to adhere to whatever rules he negotiated for state government contracting in that and future deals. But a third of them have since withdrawn their support.

Under CAFTA, states say they wouldn’t be able to give preferences to local contractors. And laws under consideration by



BUCHANAN Free traders “can’t come out and say CAFTA is good for America”

30 state legislatures to prohibit tax dollars from going to contractors who offshore their work would be overturned by most trade agreements. “Pro-

curement rules...would constrain our ability [to favor in-state business], an outcome that is, in my view, unacceptable,” wrote Iowa Governor Thomas J. Vilsack, a Democrat, in opting out of future trade deals on procurement.

Trade rules can also come back to bite Washington, even though it led the way in putting them in place. If Bush successfully engineers the introduction of private Social Security accounts, WTO rules would require the feds to let foreign money managers and insurers bid to manage them, says Robert Stumberg, a trade law expert at Georgetown University.

“Congress has shifted a tremendous amount of power to the WTO,” he says. “But their rules are vague, and until a panel [of WTO judges] tells you, you don’t know what the rules mean.”

The Bush Administration says it is trying to negotiate better trade deals. It’s seeking a rule change in NAFTA to head off “frivolous lawsuits” and is consulting with states about their objections. At states’ insistence, for example, CAFTA specifically allows for minority contract set-asides and affirmative action programs. But the Administration continues to point out that the states also have a lot to gain from free-trade deals—reciprocal treatment for businesses within their own borders. “If states want to pass restrictions on awarding contracts, the

costs could be severe for businesses those states,” including the possibility of legal retaliation, says Christopher Padgett, an assistant trade representative who deals with the states.

But heartland capitals are more focused on the cost of free trade than its benefits. Legislators won’t “sit idly by while the constituents’ jobs are lost to competition from overseas,” Utah’s Allen wrote in a January letter to Zoellick protesting USTR’s silence on the offshoring issue.

The anti-globalization fire that belatedly begun burning in the state being stoked by the U.S.’s record \$671 billion, job-killing trade deficit. And America’s scorecard as a defendant in World Trade Organization courts isn’t helping either: It has won more decisions but lost 24, many of which were among the costliest rulings thus far.

The U.S. hasn’t yet lost a NAFTA decision, but states are carefully watching two cases filed by Canadian companies. Methanex Corp. is suing the U.S. for \$800 million over California’s ban on the use of MTBE, a gasoline additive that has leaked into the soil and contaminated groundwater. Glamis Gold Ltd. is also suing for \$50 million over California’s attempt to protect Indian burial sites in the Imperial Valley from Glamis’ open-pit mining practices.

Both claim state regulations amount to expropriation of their assets. Notes Patrick J. Buchanan, a former Illinois congressman and U.S. Court of Appeals judge who served on a NAFTA panel in 1994: “If Congress had any idea what they were voting back then, they never would have passed NAFTA.”

Even more troubling is the anti-globalization wing of the Rep-

ublican Right, which will eagerly welcome state officials into the fold. “The free traders have lost the moral and intellectual argument because they can’t come out and say CAFTA is good for America,” says Patrick J. Buchanan, the conservative talk-show commentator who has lashed out about America’s loss of sovereignty to world organizations.

No more than a handful or two of House Democrats are enthusiastic about CAFTA, and the AFL-CIO and most environmental groups are fiercely opposed. Foes on the Left estimate that as many as 40 House GOP members could vote against the pact, which would likely doom the deal that happens, some of the loudest sighs of relief will be heard in state capitals. ■

—By Paul Magnusson in Washington

What Troubles The States **Now...**

- WTO rules overriding state laws on everything from gambling to recycling
- The WTO reviewing state court rulings, thus giving foreign investors extra rights

...And What They Fear in the **Future**

- New trade deals may restrict states from including buy-local provisions in their contracts
- Laws denying state contracts to U.S. companies that offshore their work will be overturned

California nixed a plan to recycle tires because of NAFTA fears

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When Givers Get Together

'Giving circles' let you have more of a say in where your charitable dollars are going. **BY JESSI HEMPEL**

IF YOUR NAME IS BILL GATES (of Seattle), you have considerable say in how your philanthropic dollars are used. But if your name is Bill Allen (of Hockessin, Del.), you may not have much direct influence on the charities you support—that is, unless you funnel your funds through what's known as a "giving circle." An idea born in the late 1990s, when New Economy dogooders sought to put their tech riches to philanthropic use, these giving circles have kept growing even as many tech entrepreneurs have seen their wealth dry up. Today there are about 220 giving circles in 39 states across the country, ranging from small groups of neighbors who organize around the dining room table to large-scale organizations such as Seattle's Social Venture Partners, which sponsors 22 giving circles with thousands of members worldwide. Now potential donors can connect to nearby giving circles through Givingforum.org/givingcircles, which was launched on Feb. 8 by the Forum of Regional Associations of Grantmakers, based in Washington, D.C.

Unlike traditional giving circles, which are often sponsored by colleges or museums and require donors to pledge a certain amount to help maintain that in-

stitution, these new philanthropic endeavors are distinguished by their hands-on approach. They are often founded by a small group of donors interested in making an impact on a certain social problem. Members are asked to chip in from \$100 to \$25,000 a year, with the average contribution around \$2,500. The cash is usually held by a community foundation, a public charity designed to save individual donors the

cost of setting up their own private foundations. Giving circle members then determine which nonprofits receive the grants, often targeting causes such as education or environmentalism. Most circles also require members to volunteer their time. Members do everything from the minimal—a service day cleaning up a local school—to the more time-consuming—a seat on the nonprofit board of directors.

'A CHECK IS JUST A CHECK'

BILL ALLEN and his wife, Kim Lum Allen, belong to the Delaware chapter of Social Venture Partners. He is a senior executive at a local financial-services firm; she heads a company that runs for-profit schools. Two years ago the couple looked for philanthropic opportunities that would allow their limited dollars to have a greater impact on their favorite cause: education. In addition to their \$7,500-a-year contribution—the annual cost for a family to join—Bill joined the SVP Delaware board, where he reviews grant applications. Kim conducts teacher training at a charter school that SVP supports. "Here, a check is just a check," says Bill. "Here,



HAPPY DONORS
The Allens' favorite cause is supporting education

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114 Scoping out a better airline seat

118 Barker: Intuit's money machine



see the difference we're making." Stanford University philanthropy professor Laura Arrillaga started Silicon Valley Social Venture Fund (SV2) in 1999 to appeal to younger donors. "They view social investments with the same importance as for-profit investments," says Arrillaga. According to the group's laws, all SV2 members get an equal share on how the group allocates its \$10,000 in annual grants. Last year, for example, they helped support local doctors who volunteered their time to care for people with chronic illnesses.

Many of these social venture groups encourage members' children to get involved. Kahryn Nix, who owns a court reporting firm, works with teens in Silicon Valley Venture Partners Arizona. Like the Phoenix chapter, the Phoenix chapter operates independently but meets certain SVP criteria such as the \$5,000 minimum donation. Her granddaughter, Lauren Fielder, 16, is one of a few dozen who raise funds through car washes, garage sales, and bowl-a-thons. Nix helps the junior givers to decide where their funds should go. Recently, after a visit to a local nursery

for homeless children, Fielder and her friends decided the children needed shoes. They sponsored a car wash and purchased 60 pairs. Says Nix: "We want to bring her up to understand giving is important."

This hands-on philanthropic culture is often what attracts donors to giving circles. In San Diego, medical entrepreneur Ted Tarbet and his wife, Michele, have been members of the local SVP chapter since 2001. When wildfires struck nearby Julian, Calif., in October, 2003, the Tarbets took their daughter,

Alexis, now 14, to Julian along with other SVP friends to help distribute food and clothing. "The clothes I was giving out weren't as nice as the ones I had at home," says Alexis Tarbet. So she collected money from SVP members, nearly \$30,000 in all, and put it toward \$275 gift certificates for every teenager in Julian. "Sure, we could write a check to the Red Cross to help victims, and we probably would anyway," says Ted Tarbet. But with SVP, he adds, you see the impact of your efforts. It beats seeing your name on some givers' plaque. ■

Venture Philanthropy

Across the country, giving groups are sprouting up everywhere. For a full list and contact information, visit Givingforum.org/givingcircles. Here's a sampling:

NAME	LOCATION	DONORS	FOCUS	DONATION*	VOLUNTEER
Social Venture Partners Seattle	Seattle	465	Strengthening nonprofits	\$5,500	Requested
Silicon Valley Social Venture Fund (SV2)	San Jose, Calif.	150	Strengthening nonprofits	2,500	Requested
Community Venture Partners	Colorado Springs	15	Arts and education	2,500	Required
The Women's Giving Circle of Howard County	Columbia, Md.	370	Programs for women and girls	100	Requested

* Annual minimum

How Clean Are the Books?

As companies begin to release new report cards on their financial controls, here's how to tell if there are problems in your portfolio. **BY DAVID HENRY**

GET READY. BETWEEN now and Mar. 16, hundreds of companies will issue their first formal assessments of their internal financial controls in their annual 10-K reports to the Securities & Exchange Commission. These new disclosures, among the most important requirements of the Sarbanes-Oxley corporate cleanup law, will likely set off storms of confusion.

And this is just the first batch: As the year rolls on, virtually all public companies will be making such reports.

In some cases companies will be filing what appear to be contradictory statements. They'll show one letter from auditors with a bad grade for their controls on financial numbers and another from the same auditors giving their O.K. to the income statements built with those numbers. Some 10% to 20% of companies will probably report problems tracking their

internal accounts, auditors estimating

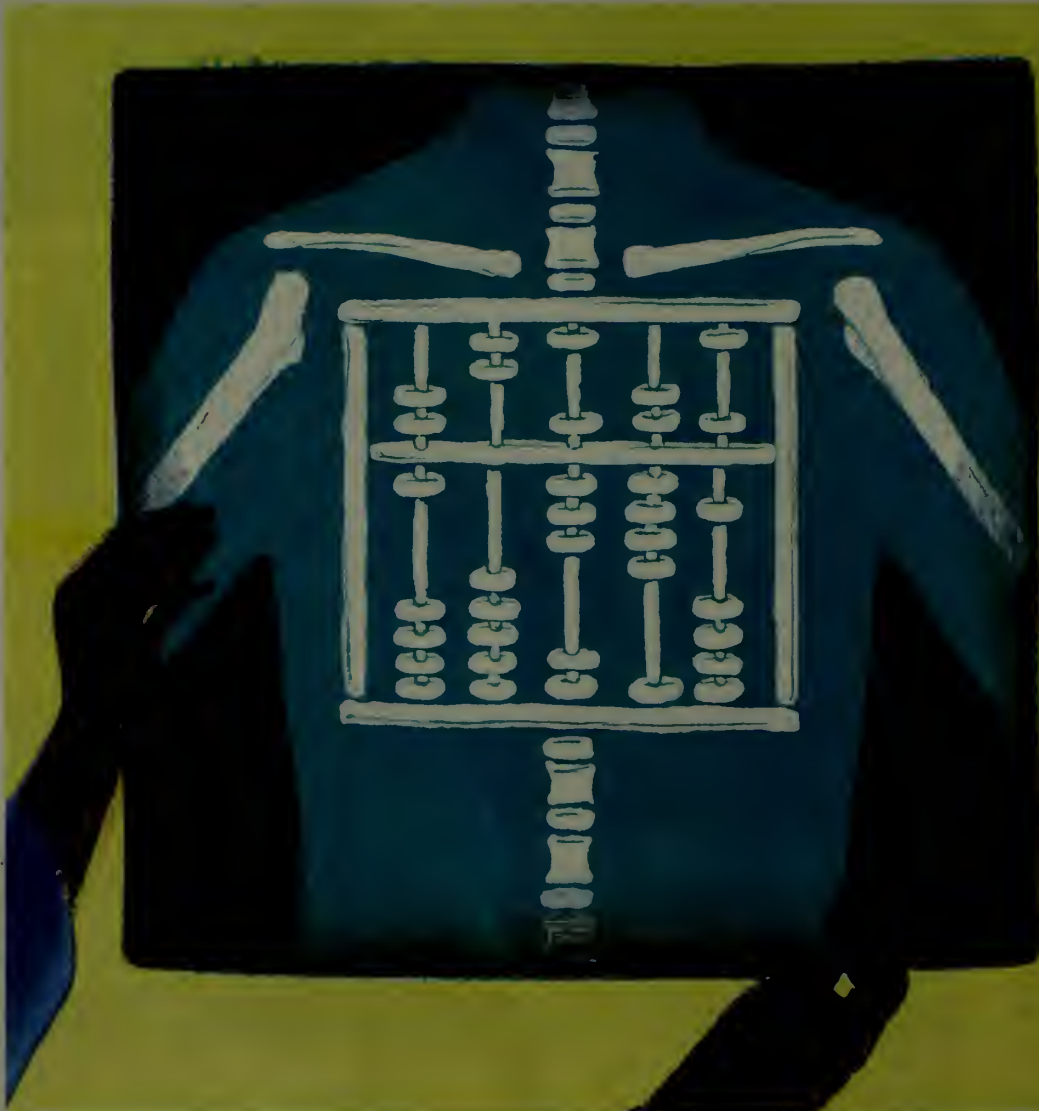
The market likely will beat down shares of some of those companies; in other cases the stocks won't flinch. "There is going to be a huge disparity," said Steven Galbraith, strategist at hedge fund Maverick Capital, at a one-day-long conference of regulators, auditors, and investors on the disclosures. That has become clear as some companies have gone ahead and fessed up ahead of the deadline. For example,

shares of Sirva, a relocation services company, plummeted 44% in the two days after it warned of problems Jan. 25. Yet shares of Eastman Kodak rose 2% after it disclosed faults Jan. 26. Why the different reactions? Probably because Sirva's problems contributed to a charge against pretax income, whereas Kodak's involved technical accounting issues over income taxes.

LOSE THE LEGALESE

REGULATORS AND auditors are urging companies to be clear in their disclosures so that investors can react appropriately. William Donough, chairman of the Public Company Accounting Oversight Board (PCAOB), which wrote the regulations, says executives should plainly describe the problems, how they happened, explain their significance, and state what they are doing to fix them. But many may still defer to their lawyers, who are sure to use legalese.

The good news for investors is that a little knowledge of the terms used in reports, plus a bit of stock analysis, will go a long





Phil Davidson

Chief Investment Officer
U.S. Value Equity



Chuck Ritter

Vice President
Senior Portfolio Manager



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name of Fund	1 Yr.	5 Yrs.	10 Yrs.	Life of Fund	Inception Date
Value* (TWVLX)	14.36%	11.46%	14.05%	12.99%	9/1/93
Large Company Value* (ALVIX)	14.28%	8.49%	—	6.59%	7/30/99
Equity Income (TWEIX)	12.53%	12.51%	15.34%	14.74%	8/1/94
S&P 500	10.88%	-2.30%	12.07%	—	—

Average annual total returns as of 12/31/04

Data presented reflect past performance. Past performance is no guarantee of future results. Current performance may be higher or lower than the performance shown. Investment return and principal value will fluctuate, and redemption value may be more or less than original cost. To obtain performance data current to the most recent month end, please call 1-877-442-6236 or visit americancentury.com. Performance reflects Investor Class shares. For information about other share classes available, please consult the prospectus. Data assume reinvestment of dividends and capital gains.

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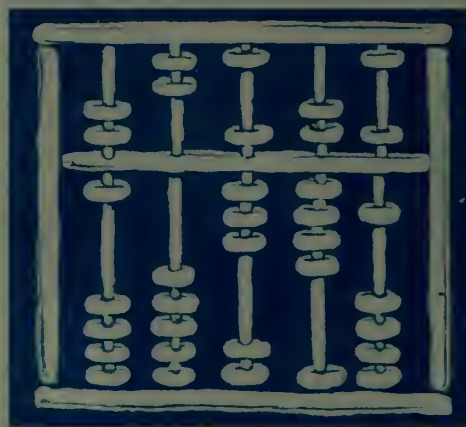
toward understanding what risks the new information reveals. Start by finding out what companies may have previously disclosed. Many companies months ago acknowledged control issues in quarterly reports or in financial restatements—and the market has already digested the news. For example, on Oct. 28 the stock of Terex, a construction equipment maker, swooned 19% and then recovered as investors sorted through its initial disclosure that its check of internal controls had uncovered contradictions in account balances. According to the newsletter *Compliance Week*, 582 companies acknowledged problems in 2004. But some of those gave few details. And some companies will probably find more serious concerns when closing their yearend books. In fact, on Jan. 31, Ceridian, a payroll services company, reported more flaws than it had revealed before.

The main thing to remember when studying the new disclosures is that a “deficiency” or “weakness” doesn’t necessarily mean any number is wrong. It just means the auditors found a way that an error could happen. That’s why auditors may still give passing grades to final financial reports. When auditors find fault with controls, they run more cross-checks on accounts to ensure that the final numbers are essentially right.

IRRELEVANT DISCLOSURES

THE STARTING POINT of any problem is a “control deficiency,” one of the terms the PCAOB established to rank the threats. It is the least worrisome level. An example would be not checking for changes a salesman may have made in terms for a minor contract. Those changes might mean revenue was counted before it was earned.

Strictly speaking, companies won’t have to disclose control deficiencies because, by the PCAOB’s definition, they carry only a “remote” chance of leading to an even “inconsequential” financial misstatement. Auditors usually think of “remote” as a 1-in-20 chance of happening. Still, probably to ward off lawsuits, some



Vocabulary of Auditorspeak

In coming weeks, companies will have to report in their 10-Ks what their auditors said about their financial controls and if there are problems. Here are the terms they may use:

CONTROL DEFICIENCY A flaw that might allow a wrong number to get into financial reports. In such cases, the likelihood that the company misstated some financial information is “remote.”

SIGNIFICANT DEFICIENCY A more serious flaw or a number of small flaws that increase the chances that bad numbers will distort earnings.

MATERIAL WEAKNESSES Enough serious flaws that there is a good chance material errors will be made in the company’s financial reports

Data: s-xinternalcontrolinfo.com

companies are disclosing deficiencies that are likely irrelevant.

More serious are “significant deficiencies.” These result when companies have so many deficiencies of enough total import that there’s “more than a remote” chance of significant misstatement. An example could be not checking for

changes to the terms of several key contracts. Significant deficiencies need to be reported to directors, but some companies are making them public anyway.

The worst are “material weaknesses” and they must be disclosed. That means a company’s deficiencies are so bad there’s “more than a remote” chance of a “material” misstatement in financial reports. Regulators admit they have come up with a satisfactory guideline for how much is “material,” but it is sometimes thought of as being enough to move a stock’s price. An example is when a bank does not regularly check for errors in estimating loan-loss expenses. An undetected error, for instance, could be rooted in a formula in a computer spreadsheet that projects how much current lending is sour. Fannie Mae, the mortgage finance company, reported a \$1.3 billion error from its computer models before its accounting scandal late last year. “Sometimes these models are built in spreadsheets in uncontrolled environments where mistakes can go undetected,” says Tim Ryan, partner at auditor PricewaterhouseCoopers. He says a lot of the material weaknesses he’s seeing is with flaws in checks on formulas used to figure income tax expense, which is different than the amount actually paid in a period.

Part of judging material weaknesses is assessing how they threaten earnings. Problems in valuing financial assets could mean big trouble for banks, but probably not for computer services companies. Computer companies are more at risk from inadequate monitoring of contracts. Issues in tracking tax expenses, which are near the bottom of income statements, are generally less worrisome than those involving top-line revenue.

The reports can also give clues to how much management cares about getting their numbers right. Be more wary if the disclosures seem incomplete or if the problems run throughout the company and have existed for years. Are executives committed to fixing the problems? If not, there’s more risk in continuing to own the stock than you thought. ■

Assessing the Damage to a Stock

When auditors find “material weakness” at a company, the stock could take a hit. Should you sell or hang on? Here’s what you need to ask:

- Is management explaining the problems clearly?
- Do the problems stem from management having a cavalier attitude toward financial reporting?
- Are the problems temporary and isolated, or systemic?
- Do the problems involve transactions that are basic to the business and earnings?



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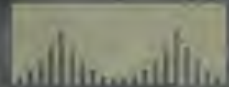
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A Bottom Fisher's Big Haul

Fairholme Fund holds few stocks but has fat returns. **BY SUZANNE WOOLLEY**

THE PORTFOLIO MANAGERS at the Fairholme Fund don't rattle easily. Good thing, since on a recent morning they were greeted not just with the news that their second-largest position, MCI, was to be acquired by Verizon Communications at what they consider a "disappointing" price but also with SBC Communications' announcement that it planned to pull a big chunk of business from a subsidiary of Leucadia National, a diversified holding company in which Fairholme also has a big stake. MCI and Leucadia make up 30% of the fund.

Highly concentrated positions are a hallmark of the \$300 million Fairholme Fund, which holds 17 stocks and recently celebrated its five-year anniversary. The strategy has been successful so far: The value-oriented no-load fund has racked up an 18.9% annualized return since its Dec. 29, 1999, inception, blowing away the -2.3% annualized return of the Standard & Poor's 500-stock index over that period. Its worst year was 2003, when it lost 1.6%. Naturally, Fairholme's ratings are top drawer. *BusinessWeek* rates it A, the top grade for risk-adjusted returns, when compared with all other equity funds and with funds in the all-cap category.

If Fairholme's telecom holdings are volatile, the No. 1 holding is a rock: Warren Buffett's Berkshire Hathaway accounts for almost 19% of the fund and was one of the first stocks the fund bought. Managers Bruce Berkowitz and Larry Pitkowsky, along with analyst Keith Trauner, are fans of Buffett and stress the importance of managements of high integrity that treat shareholders as partners and own a good chunk of company stock. Like Buffett, Fairholme's man-

agers follow the principles of legendary value investor Benjamin Graham, keying in on a company's assets and cash-generating ability.

Their intense analysis of cash flow played a big part in Fairholme's purchase of defaulted WorldCom debt in the summer of 2003, which evolved into Fairholme's MCI equity stake. "We knew from the cash they generated during the most difficult of times—bankruptcy, scandal, being in the doghouse with the government—that it could survive," says Berkowitz.

The firm also acquired a telecom stake by buying the defaulted debt of WilTel Communications Group in 2002. In

BUFFETT FANS
Fairholme's Berkowitz, Trauner, and Pitkowsky

2003, Leucadia, already a large Fairholme holding and a major holder of WilTel debt, acquired WilTel. The recent news that SBC plans to end its long-term

liance with WilTel sent Leucadia stock down 6.3% in three days. Fund manager Pitkowsky maintains that predictions of WilTel's demise are too pessimistic and that if SBC ends its contract there will be "a reasonable settlement

SNUBBING DOT-COMS

FAIRHOLME'S BOTTOM-fishing during the telecom bust has left the fund with large exposure to a now-hot sector. "They're going to places where some times current prospects look pretty terrible," notes Morningstar analyst D. McNeela, an admirer of the fund. In the fund's first year, Berkowitz passed on the dot-com craze. And what exciting field did he choose to buy into instead? Property and casualty insurance. His unwillingness to jump into tech led \$100 million to leave the fund's parent, Fairholme Capital, but holdings such as Berkshire Hathaway, Mercury General, and White Mountains Insurance Group gave the fund a 46.5% gain for 2000. Berkowitz continued to buy P&C insurers after September 11. The fund's holdings have largely escaped the recent insurance-industry scandals.

Berkowitz' ties to the insurance industry run deep. Last year, White Mountains Insurance invited him to join its board. Yes, says Berkowitz, that presents a con-

Fairholme Fund

SYMBOL FAIRX

ASSETS \$300 million

SALES CHARGE None

EXPENSE RATIO 1%

AVERAGE ANNUAL TOTAL RETURN* 20.2%

YEAR-TO-DATE TOTAL RETURN 0.4%

BUSINESS WEEK RATING A

PORTFOLIO MANAGERS Bruce Berkowitz, Larry Pitkowsky, Keith Trauner

TOP HOLDINGS Berkshire Hathaway, MCI, Leucadia National, Penn West Petroleum, AT&T

PHONE 866 202-2263

WEB SITE www.fairholmefunds.com

* Five years ended Feb. 18, 2005
Data: Fairholme Fund, BusinessWeek





, since he's restricted as to when he buy or sell the stock. But he says the osure he gets to top minds in the in-try benefits his shareholders. Closer ome, he can brainstorm with a savvy estor by walking down the hall of his rt Hills (N.J.) office building—to the ces of the Mutual Series funds and buddy, David Winters, a top-notch estor in distressed securities.

nergy is another key sector, and the agers have unearthed opportunities Canada. "We found a few companies generate huge amounts of cash and run by good people," says Berkowitz. Fairholme bought Penn West Petroleum and Canadian Oil Sands Trust depressed prices, before the market ognized their potential.

Besides getting a good deal when y invest, the Fairholme managers try ve shareholders good value for their ey. The fund's expense ratio is 1%; peer-group average is 1.43%. Berkowitz says the fund could attract more ey if it paid distribution fees to bro-ers, but it won't, because that would in-ase costs for shareholders.

Fairholme trades infrequently, pre-ting a long-term relationship with its dings, but the managers are not pas-e. They've been vocal in the battle for I, arguing that the bids are too low. e'll strive to ensure that any acquirer s a fair price," says Berkowitz. By king hard for his shareholders, he es they will stick around for the long n, too. ■

Now This Is One Smart BMW

The 3 Series sport models are loaded with innovative digital features. **BY GAIL EDMONDSON**

IBRACED FOR A HAIR-RAISING skid as my car sped into a tight curve on a track covered with simulated ice. But the new BMW 3 Series sedan refused to fishtail. Sensing the rear wheels were losing traction, BMW's new "dynamic stability control" kicked in. It adjusted the steering and brakes perfectly to avoid a skid, and I never felt a moment's loss of control.

BMW has long wielded innovation to improve the handling and safety of its cars. Still, the auto maker's latest advances, packed into the 3 Series sedan, are impressive. It has brakes that know to dry themselves every 60 seconds when it rains, a system that ensures manual-transmission cars stopped on a hill don't roll backward when the driver starts to accelerate, and an automatic signal that prepares the car to brake if the driver's foot comes off the gas pedal quickly, shaving a second or so off the car's reaction time. Slam the brakes at 60 mph, and the car comes to a quick and controlled stop.

The fifth-generation 3 Series, which starts at \$31,700 and arrives in showrooms in March, looks great. It has a sleek silhouette that looks more like a coupe than a sedan. The shoulder line slopes upward toward the rear, and the back fenders bulge out, giving the car a dynamic stance. The first two models, the 325i and 330i, will sport new six-cylinder engines (ranging in horsepower from 215 to 255). The 330i goes from zero to 60 in 6.1 seconds; the 325, in 6.7. The interior is roomier—higher (0.8

inches), longer (2.2 inches), and wider (3 inches) than its predecessor. You have to applaud BMW's detailed attention to creature comforts. For instance, the car's sensors detect when sun is shining on half the driver's body and regulate the air-conditioning to bring the temperature on the warm side in harmony with the setting on the control panel.

The much-derided onboard information system, iDrive, is also available as an option for the first time on the 3 Series.

2005 3 SERIES
From \$31,700



BMW has taken pains since the iDrive's introduction in the flagship 7 Series sedan in 2002 to make the system more user-friendly. By holding the iDrive button to the far right for two seconds, for example, you can avoid the tedious step of going back to the main menu and toggle directly from a CD to the navigation control. Other carmakers' systems are more intuitive, but the tweaks should keep you from tearing your hair out.

It's hard otherwise to find any fault with the car. With great handling, dynamic styling, and added safety features, the 3 Series lives up to its legend as the pacesetter in compact sporty sedans. ■

BusinessWeek online For a Q&A with BMW's chief of electronics, Ulrich Heiden, go to www.businessweek.com/extras

Plain Truth About Plane Seats

Web sites can show fine details of the seating plans for your aircraft. **BY CHESTER DAWSON**

FOR MARTHA WADE STEKETEE, 47, a gold-level frequent flier, the quest for the perfect seat began in earnest four years ago, after a grueling flight home from Paris. Knowing what an ordeal long flights can be, the research associate in the Arlington (Va.) office of the National Center for State Courts had nabbed a front-row economy seat, where service is usually more prompt and a quick exit on arrival is assured.

What should have been a comfortable trip became a nightmare when Steketee realized she was opposite the restrooms. "I was at one with my fellow passengers the entire flight," she says. "That experience underscored for me the need to know where the bathrooms, kitchen, and crew galley are located."

With more people flying, reduced services and seat widths, and computerized reservations that seem to fill every seat, it's tough to fly in style—let alone in comfort. Everybody has a story about a plane seat from hell; the one that wouldn't recline, had zero legroom, or was in the dreaded "sea of seven" middle row. Clearly, not all coach seats are created equal.

To cope, more travelers are taking advantage of their airline's Web sites to select a seat before ever setting eyes on the gate agent. Most major U.S. airlines offer that function for those who book reservations online or are members of frequent-flier programs. That takes much of the guesswork out of flying and, when middle seats are unavoidable, prepares travelers for the inevitable squeeze.

But the savviest leisure travelers and road warriors are



Sitting across from the restroom can sink a trip

turning to specialists for information that goes far beyond the simplistic aisle-or-window layouts offered online. One of the most popular is SeatGuru.com, which gives detailed seating plans for 25 airlines based in the U.S. and overseas. Better yet, the site dishes up frankly worded annotations on good, bad, and average seats in coach, business, and first class—mostly based on tips from the frequent fliers who make up the site's fan base and contribute hundreds of suggestions a month. "We get a lot of people who say: 'I don't know why I'm telling you, but this is the best seat on the plane,'" says Susan Daimler, vice-president of the Seattle company, whose husband, Matthew, began the site as a hobby in 2001.

SeatGuru spells out, for example, where coach seats on Continental Airlines 767s have power-port access for laptops (rows 16-23) or where those "trick" bulkhead seats with immovable armrests are installed on Northwest Airlines' 747 jumbo jets (avoid rows 10 and 29).

CAT OUT OF THE BAG

OF COURSE, the definition of a good seat varies by passenger. Some people would rather have a stiff-backed seat with a built-in entertainment console than one with a generous pitch and no movie options. For those with longer legs, SeatGuru notes that row 9 on the Embraer 135, American Airlines' workhorse for short hops, has extra legroom. "It's letting everybody in on the cat out of the bag."

For frequent fliers, the choice is often between level frequent-flyer seats and seats that would have known better, says Wade Perrin, consumer editor at *Condé Nast Traveler*. Even many airlines set their top customer choice seats.

SeatGuru is updated weekly and is funded by advertising revenue. Recent additions include Singapore Airlines and Hong Kong-based Cathay Pacific Airways. Sites with similar information include UK-Airline.com for European airlines and SmartTravelAsia.com for Asia.

Some shortcomings: Not all carriers are covered, and the amount of information on some types of planes can be limited, especially for newer aircraft. SeatGuru's Daimler says more information is being added all the time. She recently flew from Chicago to Washington, D.C., just to review United Airlines' E-70 jet plane. Her discovery: The seat in row 18 don't recline at all, "and are close to the lavatory."

As airlines cut back on service, a good seat can make all the difference between a relaxing trip and an ergonomic disaster. Of course, even the best seat can be uncomfortable when flying on an empty stomach. So before boarding, make sure to check out the menus, pictures, and comments at AirlineMeals.net. Of course you can always pack a lunch. But you can't bring a seat along with you. ■

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TAXES

HURRICANE HELPER

IF YOU'VE SUFFERED a loss because of a hurricane or other natural disaster, the tax code may offer relief. Taxpayers who itemize can deduct disaster losses not covered by insurance or federal aid. You must first reduce the amount of your loss by \$100. Then, only the portion of your loss that exceeds 10% of adjusted gross income is eligible. With adjusted gross income of \$150,000, you can deduct losses above \$15,000. So if you had \$25,100 in uninsured losses, you could claim \$10,000, says Laurie Asch, senior analyst with tax information provider RIA.

You may not have to wait until you file your 2004 return to claim this deduction. If your loss was in a disaster area declared by the President, you can amend your 2003 return—and that will speed the refund.

—Anne Tergesen



CURRENCY

The smart money is going overseas, because that's where many portfolio managers think they'll get the biggest bang for their buck. The reason: Returns depend not only on **how well the foreign market performs** but also on the value of the local currency relative to the U.S. dollar. If you're using mutual funds for your international investments, choose funds that don't hedge foreign currencies.

Country	Britain	Canada	Germany	India	Japan	Mexico
Stock market return in local currency	16.24%	13.33%	7.50%	13.59%	10.25%	38.64%
Stock market return in U.S. dollars	17.94	23.65	11.78	17.21	13.85	36.99

*For the 12 months ended Feb. 21, 2005

Data: T. Rowe Price; Morgan Stanley Capital International

INVESTING

A Fund to Savor

WHEN IT COMES TO liquid investments, nothing beats fine wine. If you don't have the expertise to assemble your own collection or a suitable place to store it, you might consider one of the new wine funds. They work like a mutual fund: investors pool money and a manager buys and sells wine—mostly from top producers in Bordeaux and Burgundy. Such funds are often based in Europe and the Cayman Islands and they're lightly regulated. That means fees can be high and disclosure spotty.

But wine funds could be heading to the U.S. Richard Bakal, executive director of the **Wine Trust**, a collector and seller of fine wines in Ridgefield, Conn., plans to launch his own fund, **Wine Trust II**, in the next 18 months. Bakal, who has been collecting since the late 1960s, says his portfolio increased by an average of 12% a year after expenses since 1980. Annual returns on the 2000 Bordeaux vintage, considered one of the best ever, have been in excess of 20%. Of course, wine is more for enjoyment, not just for financial gain, so Bakal plans to allow investors to take all or part of their profits in drink.

—Amy Co

HEALTH

SIMPLE REMEDY

DIABETICS MAY one day be put on a regimen similar to the daily aspirin taken by heart patients to ward off heart attack and stroke.

Researchers at the **Joslin Diabetes Center**, an affiliate of **Harvard Medical School**, have found that salsalate, a chemical cousin of aspirin, reduces a low-grade inflammation linked to Type 2 diabetes, the most common form, which afflicts 18 million Americans. So far, research has focused on mice, but the center has applied for a grant to fund clinical trials in humans.

—Carol Marie Cro

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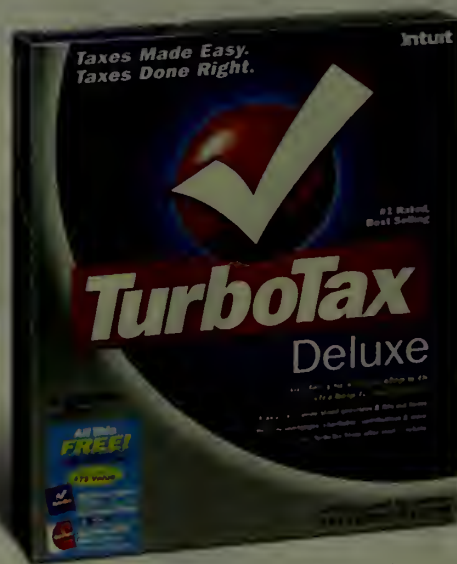
BY ROBERT BARKER

Why These Times Are Not So Taxing for Intuit

At irs.gov, the very first link is Free File—an invitation to use, gratis, the sort of tax-preparation software that often goes for \$30 or more. That would seem to be handwriting on the wall for Intuit, one of the companies that Uncle Sam lassoed into the Free File initiative and the maker of the leading tax software, TurboTax.

Investors are worried, keeping a lid lately on Intuit's shares, near 41. Yet as I do my own Form 1040 (with an assist from TurboTax), I can't help thinking the market is obsessing over the threat of Free File while missing the opportunity it presents Intuit. At the same time, investors seem to be downplaying the Mountain View (Calif.) company's many strengths. On Feb. 17, Intuit reported 5% growth in its latest-quarter revenues, which, in addition to TurboTax, include sales of its personal-finance software Quicken, small-business software QuickBooks, plus a variety of other products and services. The picture is bright enough that, for fiscal 2005, ending in July, CEO Stephen Bennett raised his estimate of revenue growth from as little as 6% to at least 8%.

SO WHY THE CLOUD OVER THE STOCK? Nagging worries about Free File, for one. Another problem may be that, with the passage of time, Intuit no longer appears to investors to be a sprightly Silicon Valley star with hot prospects. Based on such expectations, the stock traded just two years ago at more than 70 times trailing earnings (chart). Dismay that it can't grow fast enough to support such multiples now has it trading at 24 times the last four quarters' earnings. Yet business keeps expanding nicely, with operating margins this year widening from 15% to 15.8%.



SOFTWARE GALORE

New versions may buoy Intuit's stock

Fueling Intuit's growth is a vast extension of software titles. For example, where QuickBooks had only a couple of versions, the brand now anchors titles aimed at a whole bunch of niches. There's QuickBooks Simple Start, QuickBooks Enterprise Solutions, QuickBooks Professional Services Edition, QuickBooks Contractor Edition, and more. To see how widely QuickBooks has been adopted by American businesses, search the name at Monster.com or CareerBuilder.com, where employers look to hire people with QuickBooks expertise. I tried that the other day and got 1,000 help-wanted ads at Monster.com more than 1,500 at CareerBuilder.com.

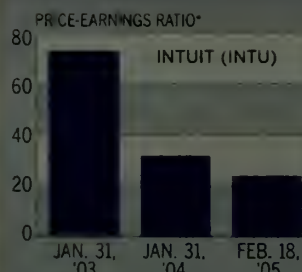
Such ubiquity, which extends to category leaders Quicken and TurboTax, spells steady cash flow. In the past four quarters, on \$1.9 billion in sales, Intuit generated \$572 million in cash from operations. It spent \$400 million on capital projects. So, with other cash it took in from exercises of employee stock options, it had free cash flow enough to buy in \$633 million in stock. Given the strength of its balance sheet—cash and liquid investments of \$885 million against no debt—Intuit is likely to keep buying shares with its free cash flow. Bennett also told me that if investors want one, Intuit would pay some of its cash out in a dividend.

Meantime, Intuit is doing what it does best: taxes. The Internal Revenue Service's Free File program, which encouraged some 20 tax-prep companies to offer basic service for free, siphons off a small part of the total market. Of 130 million returns filed in 2004, 3.5 million used Free File, according to Bennett. Filers who choose TurboTax make the company money, as many opt to buy Intuit's service for preparing state income tax returns. Demand is strong enough that Intuit is raising those prices, which vary by state.

Taxpayers who come to TurboTax via Free File are decidedly younger than average, and Intuit aims to convert them to fully paying software users as they age into more complicated tax situations. "Free," Bennett says, "is not free. This is one more ugly truth about tax time—and reason to think talk of Intuit's trouble is exaggerated. ■

E-mail: rb@businessweek.com

EXPECTING LESS



*STOCK PRICE DIVIDED BY LAST FOUR QUARTERS' DILUTED EARNINGS PER SHARE
Data: Capital IQ

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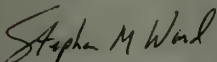
We're not just staying, we're excited about this new opportunity. We will be one of the top three PC companies in the world. We're focused. Our goal is clear:

We are dedicated to the success of every customer, and to innovation in PCs.

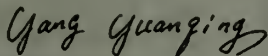
So what is Lenovo's commitment to you? Continued innovation in ThinkPad and ThinkCentre desktops. Relentless focus on quality. The products you know, made better with every innovation. Service from IBM, the world's leader in customer satisfaction, and from our business partners around the world. So whether you own a ThinkPad, or are ready to become a ThinkPad owner, know this:

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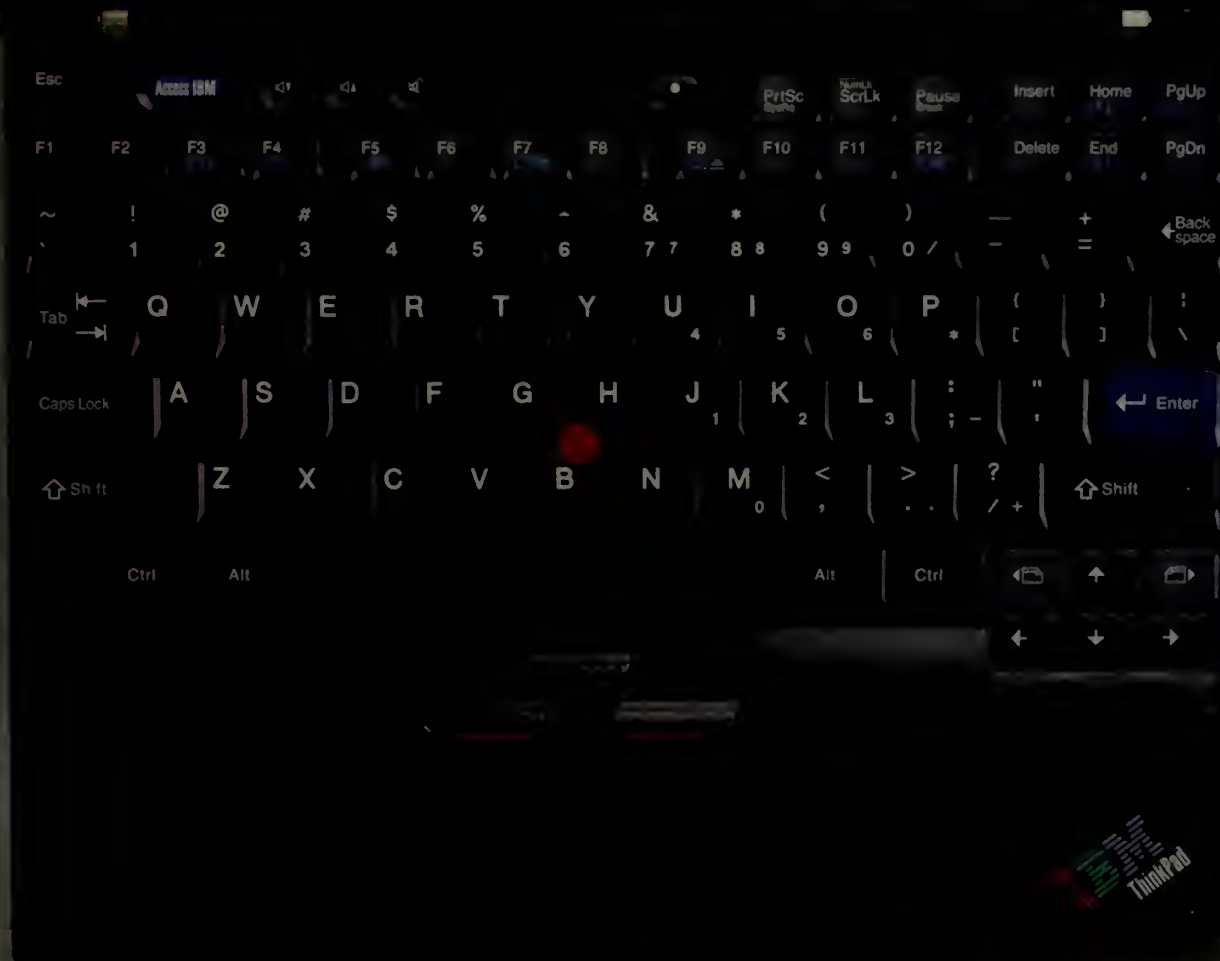


Stephen M. Ward, Jr.
Proposed CEO of Lenovo Group



Yang Yuanqing
Proposed Chairman of Lenovo Group

ONLY ON A THINKPAD.





BY GENE G. MARCIAL

ANADARKO PETROLEUM LOOKS LIKE A SMART PLAY IN THE OIL PATCH

AT AFC, POPEYES CHICKEN IS EATING ITS SPINACH

JOHNSON & JOHNSON GIVES MICROVISION A VOTE OF CONFIDENCE

Consolidation, Ho?

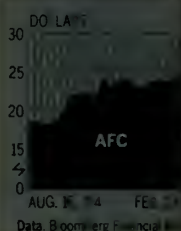
HOW HIGH WILL THE OILS GO? They have been on a rampage, with the S&P Composite 1500 Energy Index up 15.5% so far this year vs. a 0.8% fall by the S&P 500-stock index. Some experts, including Fadel Gheit, oil guru at Oppenheimer & Co., figure that oil stocks are still way undervalued, based not only on the rising prices (crude topped \$51 a barrel on Feb. 22) but on proven reserves. And the industry, he asserts, is "ripe for mergers." Charles LaPorta of Standard & Poor's is also upbeat. He says the group will earn "superior returns on capital" as a result of tight supplies and lofty prices. Adds Gheit: The oil majors are "now making more money than they can spend and are not exploring for oil—and that spells consolidation." Topping his list of buyout targets is Anadarko Petroleum (APC), a large oil-and-gas explorer and producer operating in Alaska, Louisiana, the Gulf of Mexico, the Rocky Mountains, and Texas. Its stock has soared from 49 a year ago to 70.78 on Feb. 23. Most deals in the industry are done at an average price of \$12 a barrel, Gheit notes, so he values Anadarko's 2.4 billion barrels of reserves at \$28.28 billion, or 117 a share. Gheit says Anadarko is "being courted by several deep-pocket majors," which he declines to name. Anadarko is trading at nine times his estimated 2005 earnings of \$7.74 a share, vs. 2004's \$6.36, and five times his 2005 cash-flow estimate of \$14 a share. David Heikkinen of Hibernia Southcoast Capital recently upped Anadarko from hold to buy. Anadarko declined comment.

A YEAR OF LIVING WELL



Cohen, which owns shares, says AFC is starting to cook: It has a new management team, and with cash of \$300 million, may pay off its \$98 million debt, add more Popeyes units—and deliver a dividend. Cohen sees the stock hitting 33 in a year. He expects net of \$1.50 to \$1.75 in 2006, up from an estimated \$1.24 in 2005, vs. a loss in 2004. Michael Gallo of investment firm CL King & Associates rates the stock a strong buy.

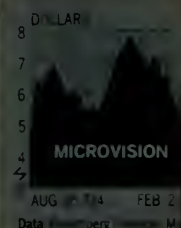
CLIMBING AS IT GETS FOCUSED



Small Eyes That Are Starting To See a Bigger Future

TINY MICROVISION (MVIS) IS FINDING LARGER tak for its minute scanners. Johnson & Johnson's Ethicon Endo Surgery unit, a leader in endoscopic instruments, just signed an \$11.7 million deal with Microvision to develop a laser scanner installed at the end of a probe used in endoscopic surgery. CEO Ric Rutkowski says Microvision's mini laser scanner emits bright color and sharp images projected on a screen. He says the J&J pact will give Microvision \$6.2 million for a prototype and the remaining \$5.5 million upon approval. James Fitzpatrick, founder of Princeton Capital Management, which owns shares, says he is impressed by the company's tiny scanners and its partnering with such customers as the U.S. Army, J&J, Canon, and Honda. And Microvision, now at 5.15 a share, has a hidden asset: It owns 33% of Lumera, a designer of molecular structures and polymer compounds for nanotechnology uses. Based on Lumera's (LMRA) stock price of 6, the stake is worth about \$32.4 million, or 1.50 a share in Microvision stock, figures Rutkowski. He sees Microvision in the black in 2006 on sharply higher sales. In 2005 the company will show a loss, analysts see sales of over \$20 million vs. 2004's \$11 million.

MORE NOTICE HIGHER PRICE



Why This Stock May Be Hot and Juicy

FOR THREE YEARS, AFC Enterprises (AFCE) has been on a chilling roller-coaster ride. Now it's drawing attention as a turnaround play as it focuses on its 1,500-restaurant Popeyes Chicken & Biscuits chain to rebuild financial muscle. After hiring KPMG in 2003 to replace Arthur Andersen as its auditor, AFC restated 2001 and 2002 earnings and sold its Seattle's Best Coffee unit to Starbucks. In 2004 it unloaded two other eatery chains—Cinnabon and Church's Chicken. Since then, AFC has popped—from 18 in August to 26 on Feb. 23. Steven M. Cohen, chief investment officer at Kellner Dileo

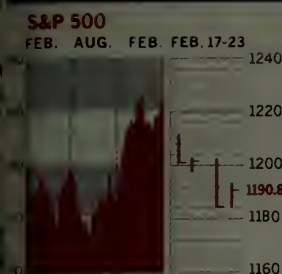
BusinessWeek online

Gene Marcial's Inside Wall Street is posted at businessweek.com/today.htm at 5 p.m. EST on the magazine's publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor the firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.

Personal Business Figures of the Week

STOCKS



COMMENTARY

As a tough week for investors, stocks fell three straight trading sessions before turning on Feb. 23. Rising oil, the aging dollar, and uncertainty regarding the Fed ate at confidence. While profits were strong at such faves as Home Depot and Lowe's, investors still sat up on the shares. The only sectors doing well in the market were oil and tobacco.

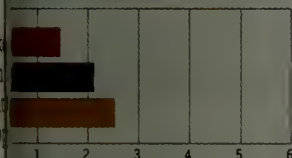
Bloomberg Financial Markets, Reuters

MUTUAL FUNDS

WEEK TOTAL RETURN

WEEK ENDED FEB. 22

S&P 500 U.S. DIVERSIFIED ALL EQUITY



WEEK TOTAL RETURN

WEEK ENDED FEB. 22

S&P 500 U.S. DIVERSIFIED ALL EQUITY



Standard & Poor's

U.S. MARKETS

	FEB. 23	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	1190.8	-1.6	-1.7	4.4
Dow Jones Industrials	10,673.8	-1.5	-1.0	0.6
NASDAQ Composite	2031.3	-2.7	-6.6	1.2
S&P MidCap 400	654.3	-1.9	-1.4	11.0
S&P SmallCap 600	322.4	-2.5	-1.9	16.8
DJ Wilshire 5000	11,718.5	-1.7	-1.9	5.7

SECTORS

	FEB. 23	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
BusinessWeek 50*	712.8	-1.4	1.2	11.8
BW Info Tech 100**	354.8	-2.2	-4.9	-0.6
S&P/BARRA Growth	572.5	-1.5	-1.6	0.6
S&P/BARRA Value	614.0	-1.7	-1.8	8.2
S&P Energy	335.3	1.5	16.2	42.8
S&P Financials	397.1	-2.7	-3.4	-0.5
S&P REIT	134.2	-3.8	-7.1	11.0
S&P Transportation	225.1	-0.8	-6.8	18.7
S&P Utilities	143.8	-3.4	1.6	19.8
GSTI Internet	155.7	-3.8	-12.7	11.2
PSE Technology	739.6	-2.5	-5.1	3.1

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS

	FEB. 23	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	1399.4	0.4	-0.2	11.9
London (FT-SE 100)	4988.5	-1.3	3.6	10.3
Paris (CAC 40)	3977.2	-0.8	4.1	6.6
Frankfurt (DAX)	4310.7	-1.3	8.7	8.7
Tokyo (NIKKEI 225)	11,500.2	-0.9	7.7	7.7
Hong Kong (Hang Seng)	13,957.9	-0.4	-1.9	1.4
Toronto (S&P/TSX Composite)	9675.7	0.4	4.6	12.4
Mexico City (IPC)	13,542.0	-0.7	4.8	38.7

FUNDAMENTALS

	FEB. 22	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	1.99%	1.93%	1.55%
S&P 500 P/E Ratio (Trailing 12 mos.)	19.2	19.7	23.4
S&P 500 P/E Ratio (Next 12 mos.)*	16.0	16.4	18.2
First Call Earnings Revision*	-0.02%	-0.80%	0.76%

*First Call Corp.

TECHNICAL INDICATORS

	FEB. 22	WEEK AGO	READING
S&P 500 200-day average	1140.2	1138.6	Positive
Stocks above 200-day average	70.0%	77.0%	Negative
Options: Put/call ratio	0.73	0.74	Positive
Insiders: Vickers NYSE Sell/buy ratio	4.42	4.16	Negative

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Constr. & Engineering	21.6	Fertilizers & Ag. Chems.	78.6
Oil & Gas Refining	18.7	Oil & Gas Refining	77.8
Integrated Oil & Gas	17.9	Steel	73.7
Oil & Gas Exploration	15.8	Oil & Gas Exploration	58.2
Steel	13.3	Constr. & Engineering	54.3

WORST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Internet Software	-9.1	IT Consulting	-48.1
Thriffs & Mtge. Finance	-7.6	Electric Mfg. Svcs.	-27.5
Tires & Rubber	-7.5	Insurance Brokers	-27.2
IT Consulting	-6.2	Semiconductors	-18.6
Computer Retailers	-5.6	Semiconductor Equip.	-18.2

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Latin America	11.6	Latin America	44.2
Natural Resources	11.2	Natural Resources	39.0
Precious Metals	8.9	Diversified Emerg. Mkts.	22.3
Diversified Emerg. Mkts.	7.6	Utilities	21.3
LAGGARDS		LAGGARDS	
Financial	-0.3	Technology	-5.1
Communications	0.9	Health	1.4
Japan	1.0	Precious Metals	1.9
Health	1.2	Large-cap Growth	2.1

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
ProFunds Oil & Gas Inv.	20.2	ProFunds Oil & Gas Inv.	66.2
U.S. Gbl. Invs. Gl. Rscs.	19.1	BlackRock Gl. Res. Inv. A	63.7
ProFunds Semicdr. Inv.	14.8	Metzler/Pdn. Eur. Em. Mkt.	57.1
iShares MSCI Brazil Idx.	14.1	iShares MSCI Brazil Idx.	52.5
LAGGARDS		LAGGARDS	
ProFds. USh. Mid Cap Inv	-6.2	Ameritor Investment	-45.5
ProFds. Intnet. Ultr. Inv.	-5.6	ProFunds Semicdr. Inv.	-31.0
Ameritor Investment	-5.3	Apex Mid Cap Growth	-29.0
ProFds. USh. Sm. Cap Inv.	-4.1	Van Wagoner Sm. Cap Gr.	-26.6

INTEREST RATES

KEY RATES

	FEB. 23	WEEK AGO	YEAR AGO
Money Market Funds	2.01%	1.98%	0.59%
90-Day Treasury Bills	2.68	2.57	0.95
2-Year Treasury Notes	3.44	3.40	1.60
10-Year Treasury Notes	4.27	4.15	4.01
30-Year Treasury Bonds	4.66	4.52	4.89
30-Year Fixed Mortgage†	5.67	5.55	5.48

†BanxQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
General Obligations	3.61%	4.43%
Taxable Equivalent	5.16	6.33
Insured Revenue Bonds	3.65	4.46
Taxable Equivalent	5.21	6.37

THE WEEK AHEAD

PERSONAL INCOME Monday, Feb. 28, 8:30 a.m. EST » January personal income is forecast to have dropped by 2.5%, after a 1% spike in December. That's the median forecast of economists surveyed by Action Economics. The \$2.2 billion Microsoft Corp. dividend payout of \$3 per share is the source of the fluctuation. January consumer expenditures probably fell by 0.2%, after a 0.8% jump in the prior month.

NEW HOME SALES Monday, Feb. 28, 8:30 a.m. EST » January new home sales most likely edged up to an annual rate of 1.11 million, from a pace of 1.10 million in December.

PURCHASING MANAGERS' INDEX Tuesday, Mar. 1, 10 a.m. EST » The Institute for Supply Management's manufacturing index probably held at 56.5% in February, after easing to 56.4% for January.

EMPLOYMENT Friday, Mar. 4, 8:30 a.m. EST » Nonfarm payrolls are forecast to have increased by 200,000 in February, after a rise of 146,000 in January. Despite the large gain in payrolls, the unemployment rate most likely remained at 5.2%.

DURABLE GOODS ORDERS Friday, Mar. 4, 10 a.m. EST » In January, new durable goods orders probably grew by 0.3% for a second straight period.

The *BusinessWeek* production index slipped to 237.5 for the week ended Feb. 12, but stayed 11.9% above the year-ago level. Before calculation of the four-week moving average, the index climbed to 237.2.

BusinessWeek online

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/magazine/extra.htm

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BusinessWeek (ISSN 0007-7135) Issue number 3923, published weekly, except for one week in January and one in August, by McGraw-Hill Companies, Inc. Executive, Editorial, Circulation Advertising Offices, 1221 Avenue of the Americas, New York, 10020. Periodicals postage paid at New York, N.Y., an additional mailing offices. Canada Post Publication Agreement Number 40012501. Return undeliverable Canada addresses to: DPGM Ltd., 4960-2 Walker Road, Windsor, ON 6J3. Email: bwcustomerservice@neodata.com
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Harvard's Lessons in Management

LAURENCE H. SUMMERS arrived at Harvard University in 2001 with an ambitious agenda. He wanted professors to spend more time with students, get more poor and lower-middle-class kids into the university, and build a second campus across the Charles River in Boston. Most of all, he wanted to expand math and science at Harvard by building a new engineering school, boosting biotech research, and dramatically updating the basic liberal arts curriculum to give every graduate a grounding in bioscience and technology.

Unfortunately, in his leadership style, Summers has proven to be more provocateur than persuader, more lecturer than listener, more threatening than reassuring to the very people whose culture he is trying to change (page 48). In his latest dustup with the faculty, his third or fourth in as many years, Summers antagonized many of the very same science faculty and researchers he needs to build his dream of expanding science throughout Harvard. The same intellectual style of challenging conventional wisdom and questioning basic principles that made him the youngest tenured professor in Harvard history also gave him a patina of arrogance that irked members of Congress when he was in the Clinton

Administration and now angers much of Harvard's faculty. Summers joins the ranks of recent leaders brought in to generate change in organizations only to misfire and fail: I. Jager at Procter & Gamble, Carly Fiorina at Hewlett-Packard, and Howell Raines at *The New York Times*. Jager, to take but one example, was the epitome of the hard-charging leader who

Summers' provocative style may push his lofty goals out of reach

his 17-month tenure, ripped through P&G, bullying, gruffly talking to employees, and generating waves of initiatives in publicly pitting himself against the corporate culture and the employees who lived it. Jager had to gain a mandate, and his reorganization effort quickly failed. His successor, Alan G. "A.G." Lafley, in contrast, has turned P&G into an innovation powerhouse, and he did it by being more collaborative than Captain Bly.

Which is precisely what Summers is not doing. He was to challenge the Harvard faculty to be open-minded about gender, but there are so few tenured women in university science departments. But by asking the gender question so insensitively and with so little intellectual rigor, he antagonized many of the very same science faculty and now risks much. By not bringing enough of the faculty along with him in making needed changes, Summers has reduced his chances of ever making those changes, even if he continues to receive the support of Harvard's governing board.

Good intentions are no substitute for good management. Creative organizations, be they universities or corporations, cannot be coerced into change. In the 21st century, they must be coached, cajoled, and coaxed.

The Courts vs. The Press

THE CREDIBILITY OF the news media in America is at a low ebb, with some justification, so this is an inopportune moment to ask for special privileges for the Fourth Estate. Yet the imminent jailing of two journalists from *Time* magazine and *The New York Times* for protecting what is widely said to be a Bush Administration source who leaked the name of a CIA agent requires action. Some 31 states have shield laws for journalists. It's now time for a federal shield law as well.

America grants legal exemptions to its citizens reluctantly, but it does grant them. Lawyer-client, clergy-laity, doctor-patient, and husband-wife relationships are all protected under the law, with limits on what testimony prosecutors can

compel. Journalists claim the same treatment for their relationship with sources under the First Amendment, arguing that a greater good for society comes from their freedom to investigate matters in the public interest.

The Supreme Court has never recognized a First Amendment privilege, but Justice Dept. guidelines do instruct prosecutors not to go after reporters except under extreme circumstances. That's precisely the nature of the state shield laws. The severity of the crime and the availability of other sources determine whether journalists must testify. The privileges under state shield laws are not absolute.

This reasonable balance test of the public interest should now be extended to the federal level. It may very well be that even under a federal shield law, *Time* magazine writer Matthew Cooper and *Times* reporter Judith Miller could be called to testify before a grand jury if someone's life had been placed in jeopardy. But this appears not to be the case. It's even clear that a crime was committed. The prosecution of Cooper and Miller fails to meet the balance test.

Recent scandals have tainted the reputation of the press, which must regain the trust of this country by upholding the strict ethical and fairness standards. But it still performs a vital function for society. While it may be difficult to define who is and isn't a reporter in this age of blogs, this should stop Congress from passing a federal shield law.

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SPECIAL REPORT BY MIKE FRANCE (P.70)

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All you need to be

Chairman's message

to the Annual Shareholders' Meeting of February 8, 2005

The 2003-2004 accounts reflect Sodexho's sound financial condition:

4.1% organic growth. Excluding the currency effect:

- EBITA increased by 7.2%.
 - Group net income rose by 20.7%.
 - Cash provided by operating activities stood at €451 million, an increase of 22.5%.
- Net debt was lowered by €294 million to €919 million at August 31, 2004.

On the basis of current information, we confirm the following objectives for fiscal 2004-2005:

- Organic revenue growth at a pace equivalent to that of fiscal 2003-2004.
- An increase in EBITA, excluding the currency effect, of 5%.

We enjoy four outstanding advantages, both now and for the future:

- Powerful competitive positions;
- A comprehensive global network in 76 countries;
- Considerable growth potential, which we estimate at €380 billion;
- An excellent financial model.

To improve our performance, the Board approved the five strategic Priorities recommended by senior management are now responsible for their deployment:

1. Adherence to our core values and for our ethical principles
 2. Accelerate profitable organic growth. Reach an organic revenue growth objective of approximately 7% in three years.
 3. Improve our management, by supporting development of leaders and creating a School of Management for executives
 4. Improve our operations and our operating margin:
 - Giving priority to improving margins in the United Kingdom.
 - By improving our procurement practices in order to improve our competitiveness
 5. Strengthen the role of the Board of Directors and reinforce internal control.
- The Board of Directors decided to ask shareholders at the Annual Meeting to elect three Directors to the Board and elect new ones.

This document contains "forward-looking statements" within the meaning of the United States Private Securities Litigation Reform Act of 1995. These include, but are not limited to, statements regarding anticipated future events and financial performance with respect to our operations. Forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts. They often include words like "believe," "expect," "anticipate," "estimated," "project," "plan," "pro forma," and "intend" or future or conditional verbs such as "will," "would," or "may." Factors that could cause actual results to differ materially from expected results include, but are not limited to, those set forth in our Registration Statement on Form 20-F, as filed with the Securities and Exchange Commission (SEC), the competitive environment in which we operate, changes in general economic conditions and changes in the French, American and/or global financial and/or capital markets. Forward-looking statements represent management's views as of the date they are made, and we assume no obligation to update any forward-looking statements for actual events occurring after that date. You are cautioned not to place undue reliance on our forward-looking statements.

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The Board of Directors has approved a 15% increase in the dividend per share to €1.70, in line with the growth in net income.

This dividend will be payable as from March 4, 2005.

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- Business And Industry
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nan reported on procedures of the
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w entering a new period.
n are bound by a shareholder's
to hold their shares, thus ensuring
future independence.
as Chief Executive Officer as

scheduled on September 1, 2005 but continue
to serve as Chairman of the Board of Directors.
Michel Landel will be appointed Chief Executive
Officer at that time. He will be fully empowered
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I firmly believe that with a stable, loyal family
shareholder base and an expanded Board of
Directors, Michel Landel, leading a strengthened
senior management team, will oversee an era
of new prosperity for our clients, our employees
and you, our shareholders.

Pierre Bellon
Chairman and Chief Executive Officer

04 RESULTS

	Fiscal 2003-2004	Fiscal 2002-2003	% change at current exchange rates	% change at constant exchange rates
	11,494	11,687	- 1.6%	4.2%
	515	514	0.4%	7.2%
nal income/(expense)	(33)	1	NM	NM
come	183	162	13.0%	20.7%
share (in €) amortization	1.53	1.41	8.3%	15.3%
share (in €) amortization	1.15	1.02	13.0%	20.7%
ed by operating activities	451	390	15.5%	22.5%

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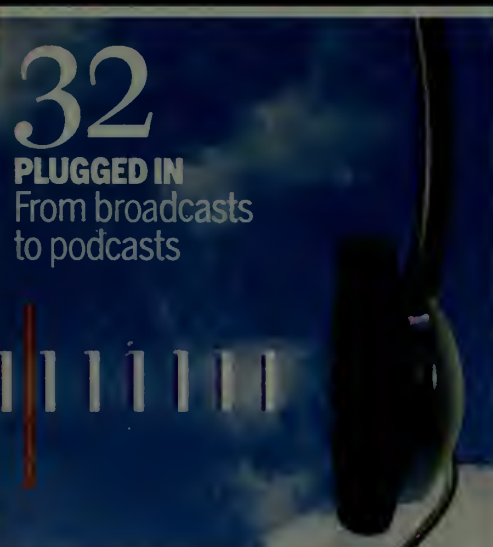
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Tort reform is more than just a matter of economic policy. The debate touches on justice itself



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From broadcasts to podcasts



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B-schools get family-friendly

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The debate is rife with heated rhetoric from both Corporate America and plaintiffs' bar, complicating any effort to arrive at an honest and evenhanded solution. What's certain is that the problem is one of abuses, not systemic failure. *BusinessWeek's* four-point plan would preserve benefits while eliminating excesses

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When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

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Technology Special Report: Inside Nanotech

Competitors in this young field are going all out to establish themselves as the leaders. With the stakes so high, it's no wonder. Plus: Hurdles for nano IPOs, health and environment worries, and more



TV: Your New Game Machine

Next-generation interactive capabilities that have proven to be a big hit in Europe are coming to the U.S. They promise to put viewers in the middle of all kinds of action—from NASCAR racing to bingo and, eventually, multiplayer games

Remembering Jef Raskin: He Thought Different

One of Apple's earliest employees and a primary force in creating the original Macintosh, the recently deceased tech genius cared deeply about humankind—and making computers easier to use



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Dairy Farmers Are Learning To Milk the Past

Like Missouri's Robert Shatto, many are finally thriving again by returning to glass bottles—and the old-time qualities they conjure



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MEDIA MANIA RADIO MAKES STRANGE BEDFELLOWS

GENERAL RADIO network Air America has an unexpected defector: **Clear Channel Communications**. The media colossus, run by execs with a knack for GOP candidates and, yes, owns 20 of the 50 stations that run Air America's programming. On Feb. 1, Clear Channel helped Air America crack the lucrative Los Angeles market. With at least 10 hours of daily programs from syndicators such as Rush Limbaugh and Sean Hannity, Air America fills a liberal niche in the San Antonio-based Clear Channel. "Listeners across the country are asking for

more progressive talk radio," said John Hogan, president of Clear Channel's Radio Div., in a prepared statement on Jan. 19 announcing the launch of Air America shows on Clear Channel stations in Washington, D.C., Cincinnati, and Detroit.

Air America is banking on Clear Channel to help it turn a profit by yearend, says CEO

Danny Goldberg, who took the helm of the New York-based company from Doug Kreeger on Feb. 23. Kreeger remains on the Air America board. Goldberg says he hopes to get the nearly year-old company on air shortly in Air



GAROFALO
Talk radio isn't all Rush

America's two untapped top-10 markets: Houston and Chicago.

As for the symbiotic relationship between partisans in the nation's culture wars, Goldberg says: "It's capitalism at its finest." Clearly. —*Jessi Hempel*

THE BIG PICTURE

WHO WANTS TO BE A CEO? A growing number of executives say they aren't interested in the corner office:

INTERESTED

27%

60%

Burson-Marsteller



WEB WATCH

Spyware's Secret Passageway

A DESIGN FLAW IN A SOFTWARE PROGRAM provided by Google is letting cyber saboteurs use blogs to infect computers with spyware—malicious software that can alter readers' Internet settings, track personal information, and launch annoying pop-ups.

The search-engine giant offers free programs that allow amateur publishers to design their own Web logs. But when bloggers want to spruce up their sites with features not available from Google—say, by adding music—they often download programs from other sites. That opens the door to spyware. While the Google software prevents bloggers from putting in their own spyware when they create a Web log, it doesn't alert them if they have unknowingly installed spyware from another source, says Ben Edelman, a **Harvard University** researcher.

Edelman, who says he found several dozen blogs infected with spyware, says Google should alert users to the potential security flaw and play a more active role in monitoring user downloads. Google says it's looking into the problem.

—*Jessi Hempel*

GLOBALISM

THE WORLD'S WORKERS MAY CATCH A BREAK

THE INTERNATIONAL

Organization for Standardization (ISO) is known for setting standards for everything from screw threads to management



systems. But on Mar. 7 it will tackle a new topic: global guidelines for corporate social responsibility.

The voluntary standards are likely to suggest reasonable child-labor

DRYING CACAO New safeguards

policies, promote equal opportunity for employees, ensure safe working conditions, and even make proposals about philanthropy. Unlike other ISO standards, this one won't entail a certification process. A key goal is to promote social responsibility in developing countries.

There are some concerns that the standards will overlap issues championed by the U.N. and other bodies, causing companies more administrative work. But the ISO carries substantial clout, so companies are scrambling to provide input. Exxon Mobil, Boeing, and Motorola are offering to help with standards,

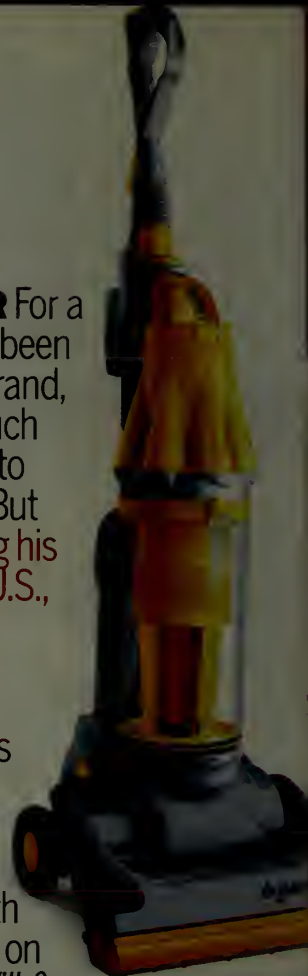
says the American National Standards Institute, the ISO's U.S. affiliate. A final draft isn't expected until 2008.

—Mark Walsh

HOME ECONOMICS

SWEEPSTAKES WINNER

For a century, vacuuming has been synonymous with one brand, whose iconic status is such that the British still refer to "hoovering the carpet." But two years after launching his bagless cleaners in the U.S., English inventor James Dyson's company now makes America's No. 1 vacuum. Dyson's suckers have 21% of the U.S. market, leaving North Canton (Ohio)-based Hoover looking dusty with nearly 16%. Guest spots on TV shows *Friends* and *Will & Grace* helped push worldwide sales up 54%, to \$812 million. Dyson's clean sweep is all the more surprising given that his product goes for \$399 to \$550, while an average vacuum costs \$150. Now who's up for a spot of Dysoning? —Rachel Tipler



BIG OIL

WHOOPIING IT UP AT APACHE

ENERGY PRODUCER Apache has found a generous way to reward workers for \$50-a-barrel oil: It's passing out hefty stock awards to its 1,900 employees. After all, the \$5.3 billion Houston company's earnings were up 50% last year, to \$1.7 billion. And its share price has doubled to \$61 in four years.

Ninety percent of the awards are going to the rank and file, with most workers receiving shares worth twice their annual salary. Even mailroom clerks will get shares worth at least as much as their salary. Now that's a gusher. —Christopher Palmeri

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FACE TIME

SIDNEY TAUREL



HOW TO COMBAT WITHDRAWAL

Early in his tenure as Eli Lilly CEO, **Sidney Taurel** had his Prozac moment. The antidepressant was accounting for nearly 25% of Lilly's sales. Then, in mid-2001, Prozac lost its U.S. patent protection. Sales sank so low it took Lilly more than a year to bounce back.

Now, Lilly is hooked on another drug. The \$13.9 billion company is getting a third of its sales from antipsychotic pill Zyprexa. This time, though, Taurel has a plan: Pump out so many new meds that their sales will more than compensate for Zyprexa's inevitable fall when Lilly's patent expires—by 2011.

Taurel, 54, may pull it off. Lilly has three other products with sales of more than \$1 billion. And Strattera, a pill for attention deficit hyperactivity disorder, should join this inner circle next year. "A blockbuster is obviously a mixed blessing," says Taurel, who is on the board of The McGraw-Hill Companies, publisher of *BusinessWeek*. "It brings a lot of revenues, but it increases your dependence." Still, it's better than an empty medicine cabinet. —Michael Arndt

ENERGY DRINKS

THE SPORT OF EXTREME MARKETING

WITH HUNDREDS of brands jockeying for shelf space, makers of highly caffeinated, \$2-a-can energy drinks are engaged in a guerrilla-marketing street fight for teens' attention. How are they slugging it out? By skipping normal TV ads, for starters. In a field littered with new entrants, each trying to out-extreme the other, energy-drink makers are pursuing increasingly audacious marketing tactics.

Without a dominating presence by either **Coca-Cola** or **PepsiCo**, energy drink companies are hoping they can become the next major brand. So far, only one leader has emerged: **Red Bull**, a private company with about 60% market share and \$150 million in sales, according to **Information Resources**, a Chicago retail research firm.

Inspired by the success of



LIL JON
Crunk!!! rap

Red Bull, more than 1,000 smaller players have entered the market hoping to gain traction by appealing to niches, says Bevnet, a beverage trade Web site. Drinks have been targeted at consumers interested in extreme sports (**Red Bull**, **Go Fast!**), video games (**BAWLS Guarana**), hip-hop (**Crunk!!!**, **Pimp Juice**, and **DefCon 3**), Jewish mysticism (**Kaballah Energy Drink**), and even marijuana (**Bong Water**). "There's an ability to get a

toehold more quickly if you can build loyalty with a niche," says Kelly O'Keefe, CEO of **Emergence**, an Atlanta marketing consultant.

Amid the clutter, clever marketing has trumped distribution. **Go Fast!** sponsored an annual bridge-jumping event in Colorado. **Red Bull** struck back with a jumper who parachuted off France's Millau Bridge, the highest in the world. Now, **Go Fast!** is funding development of a winged jumpsuit that will allow the wearer to glide out of a plane sans parachute.

The one-upmanship extends even to brand names. **Go Fast!** recently lost its edgy amateur supremacy to newcomer **Crunk!!!**, a brand owned by rap producer Lil Jon and **Grey Goose** impresario Sidney Frank.

But edgy marketing means little in the beverage industry without solid distribution. **Red Bull** has 250 distributors, but **Go Fast!** has 35, and **Crunk!!!** only 11. Analysts think the energy-drink market will probably follow the path of bottled water, which came to be dominated by **Coca-Cola** and **Pepsi**. Now may be the moment for the edgiest of startups to make their move or position themselves for a buyout. —Burt Helm

HAULS OF IVY

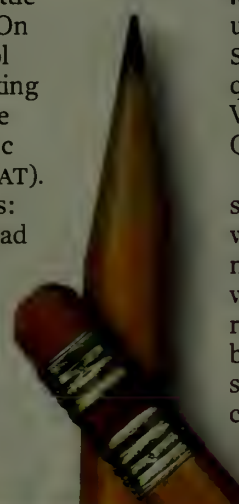
SHARPEN UP THOSE NO. 2 PENCILS

TEST TIME looks a little different this year. On Mar. 12, high school students will be taking a new version of the venerable Scholastic Assessment Test (SAT). Among the changes: three sections instead of two, a top score of 2,400 (it was 1,600), harder math, and a new essay component. It's sure to make

teens' teeth chatter but be a boon for the \$960 million test-prep market. **Kaplan**, a unit of **The Washington Post**, saw SAT-related sales jump up to 50% in the latter half of 2004. Market leader **Princeton**

Review expects up to a 50% boost in SAT-related first-quarter sales says Exec Vice-President Stephen Quattrociocchi.

SAT companies got a similar hike in 1994, when the test was last modified. While colleges will be judging students' results, investors will be looking for top scores from test-prep companies. —Burt Helm



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Recasting the Tort Debate

THERE'S SOMETHING ABOUT PERSONAL INJURY litigation that doesn't lend itself to reason. On one side, trial lawyers describe themselves as champions of the helpless when often they prove more adept at generating fees than securing fair compensation for genuine victims. On the other side,

corporate and medical advocates scream about ruinous lawsuits when megaverdicts are actually few and far between. In the middle, who's dispassionately measuring benefits and costs, preserving individual rights while promoting economic sanity, fostering safety and ethics while encouraging entrepreneurial risk-taking? Well, just about nobody.

That's why *BusinessWeek* has taken on the task of analyzing the American tort system and trying to sort out what works, what doesn't, and what could be improved. In this week's Special Report, Senior Writer Mike France, a lawyer himself, explores the history of personal injury law and the economic and political theories that underlie our system. From this starting point, he and Lorraine Woellert, Washington legal affairs correspondent, build a case for four carefully targeted reforms that should benefit businesses and consumers alike—indeed, everyone except some of the more extreme members of the plaintiffs' bar. These

proposals stand apart from the recent enacted class-action legislation, which most experts agree won't change the game fundamentally.

Our suggestions reflect *BusinessWeek's* long tradition of looking pragmatically at complex business and social problems and offering fresh approaches to solving them. We hope our proposals start a conversation on tort reform that's more constructive than the business-vs.-consumers debate that has raged so far. *BusinessWeek* looks forward to participating in the discussion—in the pages of this magazine, on *BusinessWeek* TV, and on the Web. For

starters, you'll find a useful guide to tort reform experiments in the states and a slide show of key events that have shaped liability law over the past century at www.businessweek.com/go/tortreform

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BusinessWeek

MARCH 14, 2005 (ISSN 0007-7135) ***

3924

Published weekly, except for one week in January and one in August and an additional issue the first week of April. By The McGraw-Hill Companies, Inc. **FOUNDER:** James H. McGraw (1860-1948)

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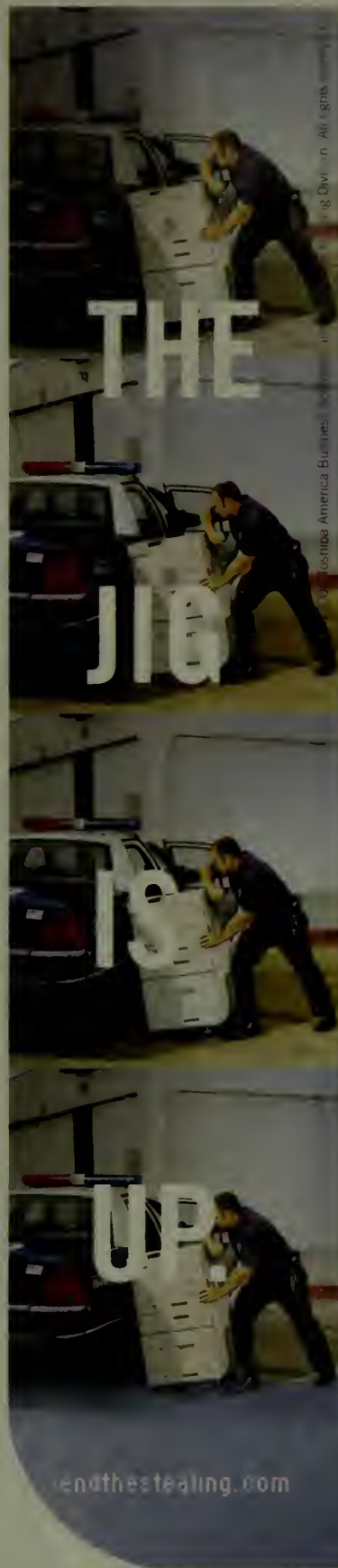
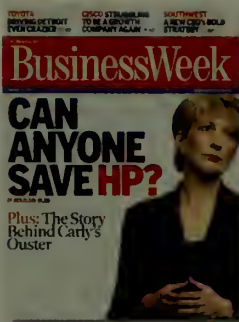
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Readers Report

HP is far from being in a state of disrepair. HP simply needs to define clearly what it wants to be."

—Barry Gross
Worthington, Ohio



OTHER LOOK AT FIORINA'S LEADERSHIP

IF YOU DON'T UNDERSTAND the intensity of much of the Carly Fiorina-bashing ("Can one save HP?" Cover Story, Feb. 21). If you lay graphs of the IBM and Hewlett-Packard Co. stock prices since her arrival at the top of each other, they match within a hair. But people don't bash Big Blue. Plus, HP stock had softened into the 20s before Fiorina dreamed of the Compaq merger. Fiorina is criticized for too much travel. I recall reading in *BusinessWeek* that Carly R. Immelt of General Electric Co. travels 26 days a month! Nobody bashes her for it. And if you've ever been a customer of Dell Inc., you know its products are clunkier, more expensive, take longer to ship, and cost more than HP/Compaq or Dell products. Yet Dell is heroic. HP also has a respectable dividend—Dell's is zero. HP could have been either a printer company—a one-trick pony—or what Fiorina sought: a major tech institution with a full line of products and cutting-edge research and development. Maybe it didn't lead well enough. But the Wall Streeters only want a spin-off-induced rebound bump, then they'll bail and let the company fade back into the garage.

—Richard M. Frome
New York

TO HAVE A LOT OF RESPECT for Carly. I believe she was correct in her attempt to move HP into the consumer market as one strategy. HP already had a strong consumer brand of products. Penetrating the market with the convergence of technology to deliver and manage digital content is a winning strategy. Just ask Apple or Dell or Sony or Microsoft. Making HP click on all cylinders is not akin to sending a man to the moon. HP is far from being in a state of disrepair. HP simply needs to define clearly what it wants to be—and mania-drive that strategy.

—Barry Gross
Worthington, Ohio

AS A CURRENT Lucent Technologies Inc. employee and former Lucent consultant, I have observed Fiorina firsthand. It is important to remember that she was trained and mentored by Richard A. McGinn and that his reign here at Lucent was characterized by the same failings that the industry is now asserting brought Carly down. They include: more than 38 data acquisitions with no due diligence, wild and unsubstantiated Wall Street financial projections, insular management with no real room for dissent or disagreement, and most important, strong marketing with absolutely no implementation plan.

Carly left Lucent before McGinn was dismissed. She was wooed by HP and viewed as its savior, who would bring HP into the 21st century. She did what she knew—and that was what had happened at AT&T and Lucent. Like McGinn, she really did not understand that corporate vision and strategic plans are more than making broad-based statements—a lot of motivational talk with no consequences for not following through. Sadly, HP, like AT&T, will probably be sold or broken up, another victim of merger mania.

—Phyllis M. Freed
Lucent Technologies Inc.
Holmdel, N.J.

THE HEART AND soul of HP is in Agilent Technologies Inc., the spin-off of the instrumentation part of HP. The company called HP is an insult to Mr. Hewlett and Mr. Packard. HP should return the HP name to Agilent and rename itself Compaq. There is no innovation at HP, only the selling of commodity items. I used HP oscilloscopes and other unique electronic instruments for many years, and I fully appreciate the innovation and technical leadership that is no longer present at HP.

—Gary Brunner
Miamisburg, Ohio

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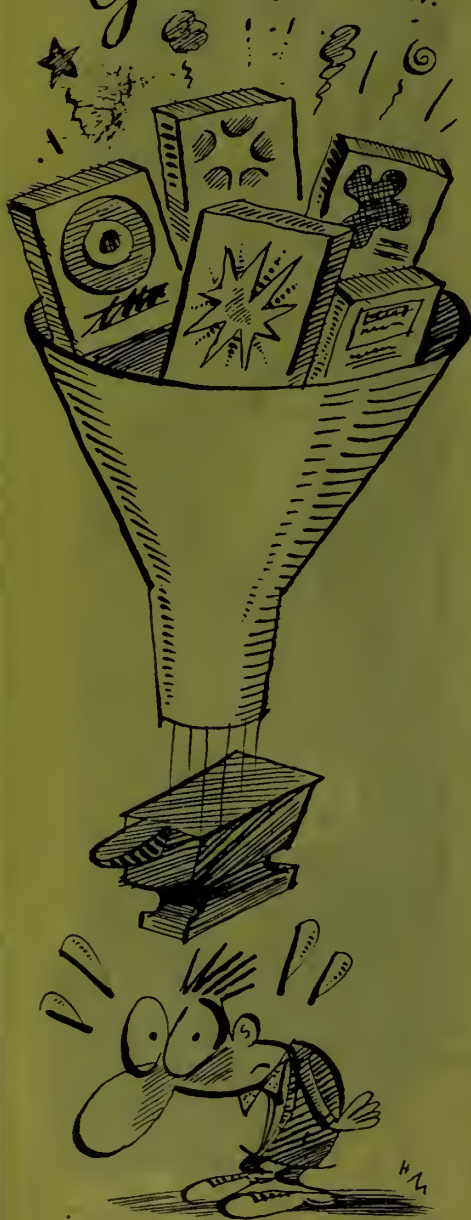
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CORRECTIONS & CLARIFICATIONS

Photographer James Porto should have received credit for the Mar. 7 cover photo "Rewiring your body."

"Stocks by the barrel: Sizing up the oil patch" (Personal Business, Feb. 28) should have cited ChevronTexaco, not ExxonMobil, as one of the oil companies that did not plan to report yearend 2004 petroleum reserves before March. ExxonMobil reported its reserves on Feb. 18. Also, the stock prices of ChevronTexaco and ConocoPhillips listed in the accompanying table were transposed.

The photo that accompanies "The sign that failure is on the way" (Developments to Watch, Feb. 28) depicts a piece of polyethylene film, not fishing line.

In "J&J may pump up Animas" (Inside Wall Street, Feb. 28), Animas makes insulin pumps (not glucose pumps) that dispense insulin based on patient entry of food data.

the call to break up HP, was one of Fiorina's strong points. While spin-offs may increase the total value of HP's stock—benefiting stockholders with only immediate gain as a motive—for the long term it would probably do more harm than good to the company and its employees. Spinning off divisions so that they stand alone in the marketplace deprives them of a critical mass to withstand the markets' ups and downs and deprives them of the synergy that occurs when similar product lines are marketed together.

—Paul D. Franson
Jacksonville, Fla.

AS A FORMER COMPAQ employee during most of the years when Michael A. Capellas was CIO and CEO, I am amazed that anyone can think he is a candidate to run HP. Rather than trying to manage Compaq to profitability and success, he tossed in the towel and sold out the company—while taking home an exorbitant exit package and leaving thousands of people unemployed. I am sure you will be hard-pressed to find any former Compaq or current HP employees who think of Capellas as a motivator and morale booster, let alone an operations expert. It looks as if he is repeating the same scenario at MCI Inc., and as an HP stockholder I am more than convinced HP does not need Michael Capellas—unless it wants to conduct a company clearance sale.

—Joe Schmidt
Houston

'THE FUTURE FOR INVESTORS IS BRIGHT'

I HAVE READ SCORES of reviews—and bad—of my books and articles never one that so misrepresented work as Michael J. Mandel's review of *Future for Investors* ("Forget the next thing," Books, Feb. 14).

His summarizing words, "Siegel's figures don't support his anti-tech sage," shocked me. Anti-tech mess. The very beginning of the first chapter starts out: "The future for investors is bright. Our world today stands at the brink of the greatest burst of invention, discovery, and economic growth known." While technology is the linchpin of economic growth, investors must be aware of what I call the "growth trap": their excitement to embrace the new technology often overpay for the very things that lead our economy forward, while ignoring slower-growing firms that give investors higher returns.

Mr. Mandel states that "most people will read the book for its treatment of technology investing." I hope not. *Future for Investors* is not about technology investing, it is about the future of the world economy. The book shows investors how to structure their portfolios for the developed world ages and the changes of economic activity shifts towards China, India, and other emerging markets.

Unfortunately, Mr. Mandel has fallen victim to the very trap that I warn of in the book. We are both optimistic about technology's role in the world economy but this does not mean that technology stocks will lead the market upward. I ask investors in the telecom industry whether their spectacular technological advances help their investments.

—Jeremy J. Siegel
Philadelphia

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Energy Crisis? Phooey

THE BOTTOMLESS WELL The Twilight of Fuel, the Virtue of Waste, and Why We Will Never Run Out of Energy
Peter W. Huber and Mark P. Mills; Basic Books; 214pp; \$26

With crude oil prices topping \$50 a barrel and another expensive driving season ahead, it seems like a bad time for a book called *The Bottomless Well*, whose subtitle promises to explain “why we will never run out of energy.” Authors Peter W. Huber and Mark P. Mills are up against headlines about OPEC throttling

the world’s oil supply, not to mention two other new books (with the same golden hue on their covers) whose scary messages are more in sync with the times: *Out of Gas* by David Goodstein and *Beyond Oil* by Kenneth S. Deffeyes.

Headlines be damned—Huber and Mills don’t budge from their big idea for a moment. The authors argue that there are “unimaginably large” amounts of raw fuel available, from oil to coal to uranium, and no risk of running short. They dynamite the idea that improving efficiency will decrease energy consumption, arguing that when energy sources become more efficient and hence cheaper, people put them to new uses and total consumption rises. But that’s O.K. with them, because they believe more energy consumption is evidence of society’s progress in satisfying human needs. Finally, they argue that the answer to the bad side effects of energy use is to consume even more of it—using it to scrub pollutants from power plants and suck carbon dioxide out of the atmosphere.

In short, Huber and Mills really, really like energy. Their long-picture, long-term perspective is refreshing, although it probably won’t satisfy people concerned about here-and-now consequences of energy use such as smog, dependence on Middle East oil, and \$2 gasoline.

It would be easy to dismiss Huber and Mills as apologists for big energy suppliers. Mills was indirectly representing energy interests in 1999—as science adviser to the Greening Earth Society, an advocacy group supported by electricity producers and their fuel suppliers—when he and Huber wrote a widely noted article in *Forbes* called “Dig More Coal—The PCs Are Coming.” Scientists at Lawrence Berkeley National Laboratory later concluded that the authors had exaggerated the energy consumption of information technology.

But *The Bottomless Well* is more than a polemic. The authors have legitimate technical credentials. Huber has a doctorate in mechanical engineering from Massachusetts Institute of Technology to go with a Harvard University law degree. He’s a senior fellow at the Manhattan Institute’s

conservative Center for Legal Policy, a *Forbes* columnist, and an author of provocative books critical of junk science (*Galileo’s Revenge*) and the mainstream environmental movement (*Hard Green*). Mills earned several patents while working as an engineer in chips and fiber optics. The two co-founded Digital Power Capital, a venture-capital firm in Washington that invests in companies that develop technology for semiconductors that handle high power.

In the spirit of like-minded author George Gilder, Huber and Mills spin broad societal themes out of fundamental science. The book has a rock-solid starting point: the laws of thermodynamics. The first one says that energy cannot be created or destroyed, only altered in form. (Matter itself can be seen as a form of energy.) The second says that any closed system gradually decays toward disorder.

Most of the book consists of elaborating the logical

consequences of those two laws. To the authors, the most important is that modern civilization depends—inevitably—on “waste.” New technologies are all based on increasing the degree of order. Example: Lasers, which produce synchronized wavelengths of light, can repair vision and carry data over optical fibers. Lasers are useful precisely because their light is so highly ordered and purified. The process of generating pure laser light from plain-vanilla electricity isn’t perfectly efficient: The total energy output is less than the total energy input, with the rest dissipated as waste heat. But that’s fine. Physics tells us that if we want to create order in one place we must create disorder—

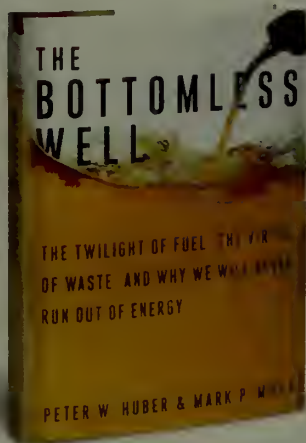
chaos, heat—somewhere else.

The authors argue that the true scarcity we face isn’t the raw fuel, but the human ingenuity to create new forms of useful order, such as lasers.

As powerful as the authors’ logic is, it becomes attenuated as the discussion moves away from the laws of thermodynamics and toward squishier subjects like politics. They may be right that

the world isn’t running out of raw fuel—there’s plenty of coal in the ground and deuterium in seawater. But it’s nonetheless true that right at the moment, dependence on oil is forcing the West to funnel money to repressive regimes in Saudi Arabia, Iran, and elsewhere. And even if they’re right that sucking carbon dioxide out of the atmosphere will save the planet some day, glaciers are melting here and now. That said, *The Bottomless Well* performs a valuable service by putting human ingenuity at the center of the debate over energy. ■

—By Peter Coy



The authors invoke laws of physics to argue there's plenty of fuel



BY STEPHEN H. WILDSTROM

New Weapons to Stop Identity Thieves

The motivation of the folks who write viruses and launch other attacks on computers is murky. But the goal of phishers, people who lure you to phony financial sites on the Web in order to steal passwords and account information, is theft, pure and simple. They pull it off primarily by fooling their unsuspecting victims, rather than by exploiting flaws in software.

That may explain why phishing incidents continue to proliferate despite the concerted efforts of software publishers to make it harder. And it is why the time has come to attack the problem at its root: the inadequacy of passwords. For Web sites where the potential losses are large, such as online banking sites, the password, no matter how cleverly constructed, has become too dangerous to use by itself.

The issue is authentication—proving that you are who you claim to be online. The strongest password can be stolen by phishing. So for real security, passwords should be supplemented with either a biometric, such as a fingerprint, or a code. In most cases, the latter is an electronic password that changes with each log-in and that's generated by a device you carry.

Biometrics work well on corporate networks, where the initial registration can be done in person, but they're problematic for online-only transactions. Code devices may have broader appeal. The best-known is the SecurID from RSA Security, which looks like a key fob for opening your car door but has a little window that displays a different six-digit number every minute. To log in to a SecurID-protected system, you enter a user name, a regular password, and the number on your fob. If it matches the number the system expects, you're in.

THE MAIN DRAWBACK of the SecurID is cost, both for the fob and the technology required to maintain tight time synchronization between the device and the log-in server. To date, it has been used mainly for corporate accounts, but America Online offers a version called PassCode to members who want greater security for their online transactions. It charges about \$33 a year for the service.

Some European banks have begun offering a lower-tech alternative. They mail their customers a card or sheet that contains a series of scratch-off numbers, something like a lottery ticket. To begin a transaction, the customer scratches off the next available number and enters it on the log-in screen. If it matches the number the system expects, the

customer gets into the system. When the numbers are gone the customer gets a new card. At \$10 a year, it's cheaper than the SecurID—but may still be too pricey for mass use.

User Name:	jsmith		
Password:	*****		
IdentityGuard:	A2	C4	F3
	9	2	6
Submit			

SECURE? IdentityGuard generates random passwords for one-time use

When you log in to an IdentityGuard-protected system, you are asked to enter your user name, password, and the digit that appears in three or four cells. You look up the information on your array, which could be printed on an ATM or credit card, and enter it to log in.

Simple as this is, there are serious limitations. People who carry a separate card for each of the Web sites they visit. Unfortunately, we get a common log-in system—something like Microsoft's failed Passport, but with broad industry support—the use of IdentityGuard-type approaches will be limited to sensitive accounts such as financial institutions and health records.

Some financial institutions are toughening up their online security to protect both customers and themselves. Bank of America, for example, has contracted with VeriSign to develop a supplement to passwords—possibly a code device—for online transactions. This is going to make doing business online slightly less convenient, but it's a necessary evil. The extra step is far less trouble than cleaning up after an identity theft. ■

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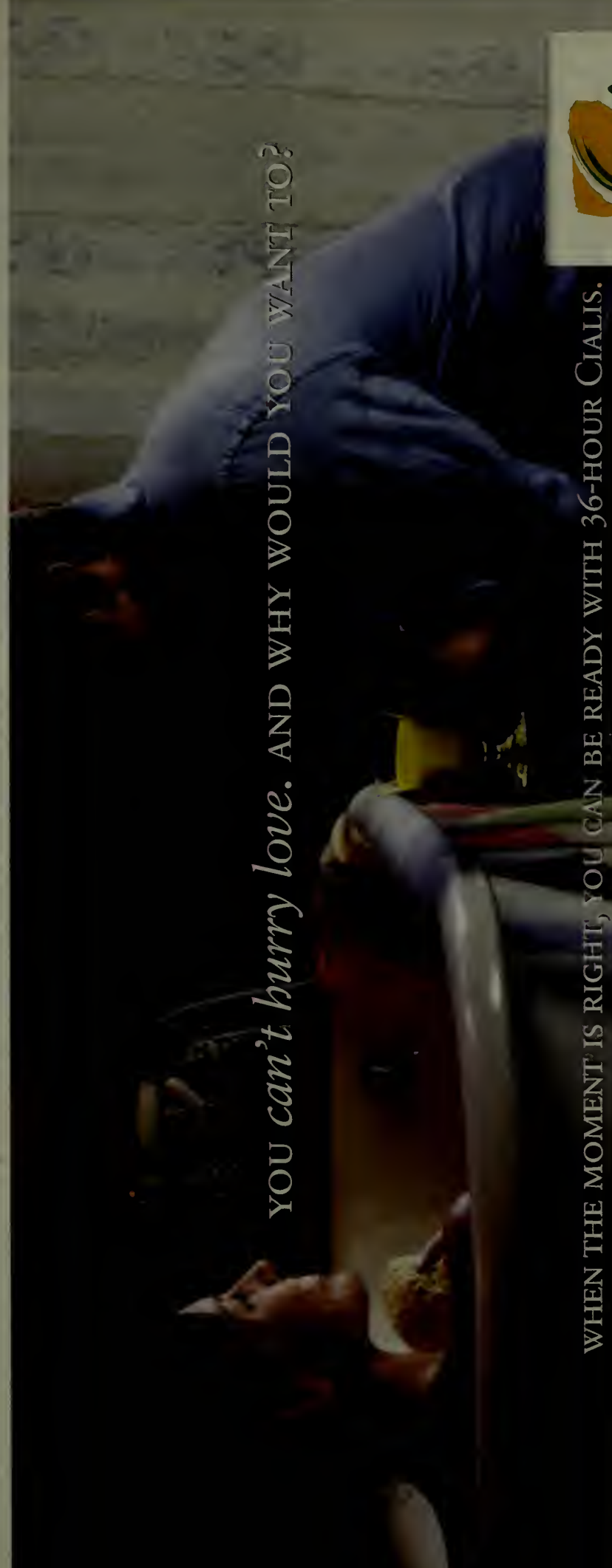
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prescribed for prostate problems or high blood pressure, do not take Cialis. Such combinations could cause a sudden, unsafe drop in blood pressure. Don't drink alcohol in excess (to a level of intoxication) with Cialis. This combination may increase your chances of getting dizzy or lowering your blood pressure. Cialis does not protect a man or his partner from sexually transmitted diseases, including HIV.

The most common side effects with Cialis were headache and upset stomach. Backache and muscle ache were also reported, sometimes with delayed onset. Most men weren't bothered by the side effects enough to stop taking Cialis. Although a rare occurrence, men who experience an erection for more than 4 hours (priapism) should seek immediate medical attention. Discuss your medical conditions and medications with your doctor to ensure Cialis is right for you and that you are healthy enough for sexual activity.

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YOU can't hurry love. AND WHY WOULD YOU WANT TO?

WHEN THE MOMENT IS RIGHT, YOU CAN BE READY WITH 36-HOUR CIALIS.

Cialis (see-AL-iss) is the only erectile dysfunction (ED) tablet clinically proven to both work fast and work for up to 36 hours*. Cialis gives you up to 36 hours to relax and take your time, 36 hours to be spontaneous and respond to your partner when the moment is right.

Ask your doctor if prescription Cialis is right for you. See important safety information above and Patient Information on following page.

*Individual results may vary. Not studied for multiple attempts per dose. In clinical trials, Cialis was shown to improve, up to 36 hours after dosing, the ability of men with ED to have a single successful intercourse attempt.



Cialis®

(tadalafil) tablets

www.cialis.com

1-877-4-CIALIS

Patient Information



Read the Patient Information about CIALIS before you start taking it and again each time you get a refill. There may be new information. You may also find it helpful to share this information with your partner. This leaflet does not take the place of talking with your doctor. You and your doctor should talk about CIALIS when you start taking it and at regular checkups. If you do not understand the information, or have questions, talk with your doctor or pharmacist.

What important information should you know about CIALIS?

CIALIS can cause your blood pressure to drop suddenly to an unsafe level if it is taken with certain other medicines. You could get dizzy, faint, or have a heart attack or stroke.

Do not take CIALIS if you:

- take any medicines called "nitrates."
- use recreational drugs called "poppers" like amyl nitrate and butyl nitrate.
- take medicines called alpha blockers, other than Flomax® (tamsulosin HCl) 0.4 mg daily. (See "Who should not take CIALIS?")

Tell all your healthcare providers that you take CIALIS. If you need emergency medical care for a heart problem, it will be important for your healthcare provider to know when you last took CIALIS.

After taking a single tablet, some of the active ingredient of CIALIS remains in your body for more than 2 days. The active ingredient can remain longer if you have problems with your kidneys or liver, or you are taking certain other medications (see "Can other medications affect CIALIS?").

What is CIALIS?

CIALIS is a prescription medicine taken by mouth for the treatment of erectile dysfunction (ED) in men.

ED is a condition where the penis does not harden and expand when a man is sexually excited, or when he cannot keep an erection. A man who has trouble getting or keeping an erection should see his doctor for help if the condition bothers him. CIALIS may help a man with ED get and keep an erection when he is sexually excited.

CIALIS does not:

- cure ED
- increase a man's sexual desire
- protect a man or his partner from sexually transmitted diseases, including HIV. Speak to your doctor about ways to guard against sexually transmitted diseases.
- serve as a male form of birth control

CIALIS is only for men with ED. CIALIS is not for women or children. CIALIS must be used only under a doctor's care.

How does CIALIS work?

When a man is sexually stimulated, his body's normal physical response is to increase blood flow to his penis. This results in an erection. CIALIS helps increase blood flow to the penis and may help men with ED get and keep an erection satisfactory for sexual activity. Once a man has completed sexual activity, blood flow to his penis decreases, and his erection goes away.

Who can take CIALIS?

Talk to your doctor to decide if CIALIS is right for you.

CIALIS has been shown to be effective in men over the age of 18 years who have erectile dysfunction, including men with diabetes or who have undergone prostatectomy.

Who should not take CIALIS?

Do not take CIALIS if you:

- take any medicines called "nitrates" (See "What important information should you know about CIALIS?"). Nitrates are commonly used to treat angina. Angina is a symptom of heart disease and can cause pain in your chest, jaw, or down your arm.

Medicines called nitrates include nitroglycerin that is found in tablets, sprays, ointments, pastes, or patches. Nitrates can also be found in other medicines such as isosorbide dinitrate or isosorbide mononitrate. Some recreational drugs called "poppers" also contain nitrates, such as amyl nitrate and butyl nitrate. Do not use CIALIS if you are using these drugs. Ask your doctor or pharmacist if you are not sure if any of your medicines are nitrates.

- take medicines called "alpha blockers", other than Flomax® 0.4 mg daily. Alpha blockers are sometimes prescribed for prostate problems or high blood pressure. If CIALIS is taken with alpha blockers other than Flomax® 0.4 mg daily, your blood pressure could suddenly drop to an unsafe level. You could get dizzy and faint.

- you have been told by your healthcare provider to not have sexual activity because of health problems. Sexual activity can put an extra strain on your heart, especially if your heart is already weak from a heart attack or heart disease.

- are allergic to CIALIS or any of its ingredients. The active ingredient in CIALIS is called tadalafil. See the end of this leaflet for a complete list of ingredients.

What should you discuss with your doctor before taking CIALIS?

Before taking CIALIS, tell your doctor about all your medical problems, including if you:

- have heart problems such as angina, heart failure, irregular heartbeats, or have had a heart attack. Ask your doctor if it is safe for you to have sexual activity.
- have low blood pressure or have high blood pressure that is not controlled
- have had a stroke
- have liver problems
- have kidney problems or require dialysis
- have retinitis pigmentosa, a rare genetic (runs in families) eye disease
- have stomach ulcers
- have a bleeding problem
- have a deformed penis shape or Peyronie's disease
- have had an erection that lasted more than 4 hours
- have blood cell problems such as sickle cell anemia, multiple myeloma, or leukemia

Can other medications affect CIALIS?

Tell your doctor about all the medicines you take including prescription and prescription medicines, vitamins, and herbal supplements. CIALIS and other medicine affect each other. Always check with your doctor before starting or stopping any medicine. Especially tell your doctor if you take any of the following:

- medicines called nitrates (See "What important information should you know about CIALIS?")
- medicines called alpha blockers. These include Hytrin® (terazosin HCl), Flomax® (tamsulosin HCl), Cardura® (doxazosin mesylate), Minipress® (prazosin HCl) or Uroxatral® (alfuzosin HCl).
- ritonavir (Norvir®) or indinavir (Crixivan®)
- ketoconazole or itraconazole (such as Nizoral® or Sporanox®)
- erythromycin
- other medicines or treatments for ED

How should you take CIALIS?

Take CIALIS exactly as your doctor prescribes. CIALIS comes in different doses (10 mg, and 20 mg). For most men, the recommended starting dose is 10 mg. CIALIS should be taken no more than once a day. Some men can only take a low dose of CIALIS because of medical conditions or medicines they take. Your doctor will prescribe the dose that is right for you.

- If you have kidney problems, your doctor may start you on a lower dose of CIALIS.
- If you have kidney or liver problems or you are taking certain medications, your doctor may limit your highest dose of CIALIS to 10 mg and may also limit you to one tablet in 48 hours (2 days) or one tablet in 72 hours (3 days).

Take one CIALIS tablet before sexual activity. In some patients, the ability to have sexual activity was improved at 30 minutes after taking CIALIS when compared to a sugar pill. The ability to have sexual activity was improved up to 36 hours after taking CIALIS compared to a sugar pill. You and your doctor should consider this in deciding when you should take CIALIS prior to sexual activity. Some form of sexual stimulation is needed for an erection to happen with CIALIS. CIALIS may be taken with or without meals.

Do not change your dose of CIALIS without talking to your doctor. Your doctor may change your dose or raise your dose, depending on how your body reacts to CIALIS.

Do not drink alcohol to excess when taking CIALIS (for example, 5 glasses of wine or 5 shots of whiskey). When taken in excess, alcohol can increase your chances of getting a headache or getting dizzy, increasing your heart rate, or lowering your blood pressure. If you take too much CIALIS, call your doctor or emergency room right away.

What are the possible side effects of CIALIS?

The most common side effects with CIALIS are headache, indigestion, back pain, muscle aches, flushing, and stuffy or runny nose. These side effects usually go away after a few hours. Patients who get back pain and muscle aches usually get it 12 to 24 hours after taking CIALIS. Back pain and muscle aches usually go away by themselves within 48 hours. Call your doctor if you get a side effect that bothers you or one that will not go away.

CIALIS may uncommonly cause:

- an erection that won't go away (priapism). If you get an erection that lasts more than 4 hours, get medical help right away. Priapism must be treated as soon as possible or lasting damage can happen to your penis including the inability to have erection.
- vision changes, such as seeing a blue tinge to objects or having difficulty telling the difference between the colors blue and green.

These are not all the side effects of CIALIS. For more information, ask your doctor or pharmacist.

How should CIALIS be stored?

- Store CIALIS at room temperature between 59° and 86°F (15° and 30°C).
- Keep CIALIS and all medicines out of the reach of children.

General Information about CIALIS:

Medicines are sometimes prescribed for conditions other than those described in patient information leaflets. Do not use CIALIS for a condition for which it was not prescribed. Do not give CIALIS to other people, even if they have the same symptoms that you have. It may harm them.

This leaflet summarizes the most important information about CIALIS. If you want more information, talk with your healthcare provider. You can ask your doctor or pharmacist for information about CIALIS that is written for health professionals.

For more information you can also visit www.cialis.com, or call 1-877-242-5471.

What are the ingredients of CIALIS?

Active Ingredient: tadalafil

Inactive Ingredients: croscarmellose sodium, hydroxypropyl cellulose, hypromellose, iron oxide, lactose monohydrate, magnesium stearate, microcrystalline cellulose, sodium lauryl sulfate, talc, titanium dioxide, and triacetin.

Rx only

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Literature revised November 24, 2003

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BY ROBERT KUTTNER

Bush's Worrisome Weak-Dollar Policy

The gap between the Bush Administration's expansive geopolitical goals and its relinquishing of financial stewardship is becoming unsustainable. On Feb. 22 one line in a report by the Bank of Korea referring to diversification of its currency holdings away from the dollar created a brief panic in financial markets. While the markets have recovered—for now—it was a

lingering reminder of the vulnerability of the dollar and the precarious position of the U.S.

The dollar is, of course, weak because the U.S. runs such large trade and budget deficits. The federal government borrows nearly \$2 billion a day abroad. Private foreign investors are unwilling to lend us that much money at current interest rates, so central banks make up the difference. In the three quarters of 2004, fully 49% of the U.S. current account deficit was financed by foreign central banks, with Japan and China the lead lenders.

Japan and China are buying dollars to keep their currencies overvalued—and their products underpriced. But this co-dependency creates a vicious cycle, with the cheaper Asian currencies and exports exacerbating the U.S. trade imbalance—and necessitating still more borrowing.

CONSIDER THE IRONY: The Administration views America as the sole standing superpower based on our military might and our willingness to use it. But Bush's failure to address the U.S.'s growing reliance on foreign central banks creates systemic risks and economic dependencies inconsistent with superpower status. The Administration comforts itself by claiming that the financial relationship between the U.S. and its creditors is reciprocal and disconnected from geopolitical issues. Supposedly, none of the creditor nations would dare dump greenbacks because they would be cheapening the value of their own dollar holdings, undermining a key export market, and risking a global depression. Dream on.

The U.S. has vital diplomatic issues with each of its creditor nations. With China these range from arms sales to currency manipulation to fair trade and differences over Taiwan and North Korea. China, a dictatorship that reigns over 1.3 billion souls, is so absent from Bush's global democracy agenda. Does Washington's financial dependence on China reduce our diplomatic leverage? Of course it does.

The Bush Administration is failing on three counts: First, mounting budget deficits increase the need for foreign borrowing and add to pressure on the dollar. Second, not pursuing a serious energy policy intensifies U.S. dependence on imported oil and widens the trade deficit. And third, the Administration isn't even attempting to manage the dollar's

decline, relying instead on the whims of money markets.

This contrasts markedly with the tenure of Ronald Reagan's Treasury Secretary, James A. Baker III. Although a staunch free-marketeer, Baker understood that exchange rates and interest rates are too important to leave to short-run currency trading. The Plaza Accord of 1985 produced coordinated interest-rate cuts and gradual depreciation of the dollar. When the pact fell apart in 1987, the stock market crashed.

A similar accord should have been on the agenda for Bush's Europe trip. Today, however, any attempt to work with other central bankers to manage an orderly dollar depreciation would require a commitment to reduce

Budget and trade deficits invite a dollar crash, followed by recession

budget deficits, which the Administration is not prepared to make. Under Bush, international economic issues and officials dealing with them are distinctly second-tier. Treasury Secretary John W. Snow has neither the stature nor the authority that Baker enjoyed, and other key positions are vacant.

Some dollar decline is inevitable, but it needn't be calamitous. Bush's fiscal policy, however, virtually invites other central banks to

reduce their dollar exposure—and OPEC to move away from pricing oil in dollars. The Federal Reserve will increasingly find itself raising rates, not because inflation is worrisome but to defend the dollar. The Bank of England did much the same in the past century—at a cost to Britain's long-term prosperity—because imperial ambitions outran the nation's financial condition.

The worst-case scenario is a dollar crash, followed by a steep recession. The shame is that sensible policies, which the Administration won't pursue, could still head off a disaster. ■

Robert Kuttner is co-editor of *The American Prospect* and author of *Everything for Sale* (kuttner@prospect.org).

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JAMES C. COOPER & KATHLEEN MADIGAN

Optimistic Businesses Are Revving Up for Growth

Companies should face less uncertainty and more demand this year

U.S. ECONOMY Corporate America is back in its groove, and that could shake up the whole economic outlook for 2005. For the first three years after the recession ended, businesses' plans for expansion and hiring were beaten back by one new source of uncertainty after another, whether it was terrorism fears, financial scandals, a

fluctuating stock market, or war. All this made the business sector an undependable contributor to economic growth. Not anymore.

Evidence of a corporate renaissance is growing. Chief executives are the most optimistic in years. And why couldn't they be? Demand continues to grow strongly. Many companies are enjoying increased pricing power. Financial resources are abundant: Internally, profits and cash flow remain strong, and externally, credit markets offer cheap long-term financing, while lending terms and conditions at banks are the easiest in years. This combustible mix appears to have reached a flash point, especially regarding capital spending. The U.S. Bureau of Economic Analysis upgraded its initial estimate of fourth-quarter growth in real gross domestic product from 3.1% to 3.8%, with increased business investment in new buildings and equipment accounting for a little less than half of the upward revision. The data also show that company outlays for new equipment grew in the second half of last year at the fastest two-quarter pace since 1997.

Perhaps the best news for 2005, though, stems from the historically tight correlation between capital spending and hiring. It should not be surprising that hiring picked up substantially last year as companies began to expand. Strong business outlays imply a continuation of job growth in 2005 that will generate a healthy pace of income to help support consumer spending. Consumer resilience along with the corporate sector's new vibe is punching up demand. That's a key reason the economy has shown no loss of momentum, either late last year or early this year. Most economists expected some degree of slowing in the economy pace, but that's not happening. Growth appears to be locked into a 4% track. As the year progresses, growth at that clip could well outpace current prospects for inflation, bond yields, and the interest rates at which the Federal Reserve keeps increasing.

OPTIMISM IN THE BOARDROOM continues to grow, as the Business Roundtable's March CEO Economic Outlook Survey. The executives' upbeat expectations for sales, capital spending, and hiring in the six months

ahead pushed the CEO Economic Outlook Index to the highest level of the expansion, implying that they believe the economy is on a solid growth path (chart).

Notably, capital-spending plans are up sharply, with 60% of the companies expecting to increase their outlays in the next six months. That's better than the 50% response in December and 43% this time last year.

CHIEF EXECUTIVES GROW MORE UPBEAT



*COMBINED RESPONSES ON PROJECTED SALES, CAPITAL SPENDING, AND EMPLOYMENT
Data: Business Roundtable

largest since the Census Bureau began keeping comparable records in 1992 (chart, page 30).

Interestingly, the yearend expiration of the bonus depreciation tax benefit, which was expected to boost outlays late last year at the expense of spending in early 2005, had no major impact. January orders and shipments suggest that capital spending on equipment in the first quarter could match or even exceed the rapid fourth-quarter advance.

COMPANIES ARE LOOKING to expand their operations, not just replace old computers and peripherals. In fact, price-adjusted outlays for information-processing gear, half of all equipment spending, grew more slowly over the course of 2004 than they did in 2003.

Taking up the slack was a surge in spending on basic machinery and other gear such as vehicles and low-tech office equipment. In fact, during the past year, spending on the low-tech side of capital equipment has grown 15%, twice its pace during the late 1990s. And that's better than the yearly growth in high-tech gear.

Companies are also starting to construct plants and

office buildings to house their new equipment and workers. After free falling from 2001 to 2003, business construction outlays are rising strongly, actually making a small contribution to overall economic growth last year. The boost should be much greater in 2005. In January, business construction was up a robust 10.1% from the previous year, with the biggest gains showing up in the manufacturing, lodging, and communications sectors.

AND EVEN AS capital spending powers its way into the year, businesses are surely heartened to see no signs that consumer spending is fading. The reason is clear: Some 2.2 million more people have jobs now than a year ago, and the added income is generating more spending. Adjusting for the huge Microsoft Corp. dividend payment in December, personal income posted solid monthly gains of 0.6% in December and 0.5% in January.

But the real story is in wages and salaries, which make up nearly three-fifths of total earnings. In January, basic wage income grew 5.8% from the previous year, the largest yearly gain in four years and twice the rate of inflation. Given further improvement in job market conditions, as suggested by fewer workers claiming jobless benefits, a jump in help-wanted ads, and consumer surveys showing better job opportunities, incomes should continue to grow at a healthy clip in coming months.

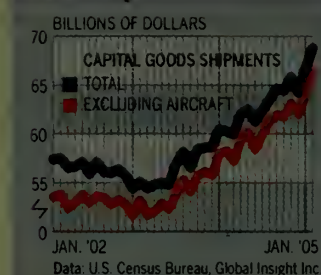
A wide range of industries is benefiting from the relentless strength in consumer and business demand, but perhaps none more than the manufacturing sector. Factory output rose strongly in December and January, as

companies continue to use a greater share of their production capacity. And in February the nation's purchasing managers said that industrial activity remained at a high level. The purchasing managers' overall index dipped from 56.4% in January to 55.3% in February, according to the Institute for Supply

Management, but the levels are consistent with economic growth greater than 4%, says the ISM.

If economic growth continues to surprise the high side of expectations, it will have important consequences. First, it would mean that the economy is using whatever slack exists in production capacity and the labor pool at a faster

SALES OF BUSINESS GEAR ARE SOARING



rate than expected. Second, strong growth would bolster gains in pricing power already evident in many industries. And third, it would give the Fed far less leeway to move interest rates up at its recent leisurely pace.

There is no doubt that the animal spirits of Corporate America are stirring unlike any time since the go-go years of the late 1990s. That optimism will boost the economy's performance this year. But the Fed will be watching closely to make sure that this new ebullience doesn't allow inflation to spiral out of control. ■

EURO ZONE

The Rebound Eases into First Gear

THE AFTERSHOCKS from last year's twin surge in the euro and oil prices hit the economy of the 12-nation euro zone hard in the second half. But while growth won't be easy, the worst appears to be over, and the stage is set for at least a modest rebound in 2005.

Eurostat's Mar. 2 report on real gross domestic product shows that the euro zone grew only 0.2% in the fourth quarter, or 0.6% at an annual rate, while third-quarter growth was revised slightly lower. Germany, Italy, and the Netherlands posted outright declines last quarter. But based on the breakdown of GDP, the news is not quite as dismal it appears at first glance.

The drag from weaker exports

continued, but the surprise was that domestic demand from both consumers and businesses in the fourth quarter was more resilient than analysts had feared. Consumer spending increased at a 1.8% annual rate, much stronger than in the second and third quarters, and business investment jumped 3.9%, the largest advance in nearly four years. France and Spain racked up

solid demand-led gains in GDP, while even in Germany, where GDP declined 0.9%, consumer spending posted a 1% advance.

First-quarter signs of continued increases in spending look hopeful. French consumers boosted their buying by more than expected in

January. More broadly, credit growth remains strong, and consumer confidence is holding up well. Even Italy, where fourth-quarter GDP fell an annualized 1.2%, January tax cuts boosted February confidence.

Much of the fourth-quarter sag in GDP resulted from a slowdown in inventory growth, as businesses cut their stockpiles after the spring and summer falloff in demand. With demand rebounding, production is now in a better position to regain its footing. German and Italian factory orders have strengthened, but industry still faces headwinds from the strong euro and the recent jump in oil prices back over \$50 per barrel.

Most economists believe that euro zone growth in 2005 will plod along at last year's 1.7% pace. That's not great, but it's a speedup from last year's second half and a far cry from the recession danger implied by last quarter's top-line GDP number. ■

FADING GROWTH IN THE EURO ZONE





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MEDIA

THE NEW RADIO REVOLUTION

From satellite to podcasts, programming is exploding—but the fight for profits will be ferocious

HOW FAST IS TECHNOLOGY turning radio upside down? Ask Brian Ibbott. Last September, when the wannabe Denver deejay started playing music on the Internet, the term for what he was doing—podcasting—had been around for two weeks. These days the 35-year-old produces a half-hour show of popular songs called *Coverville*. Some 9,000 devotees download it three times a week to play on—what else?—their iPods. And if they tire of *Coverville*, they now have 3,500 other podcasts—and counting—to choose from.

For all the hullabaloo it's generating, podcasting is not even close to being a business yet. While startups such as Odeo and The Podcast Network are pro-

viding technological support and creating a podcasting network, right now Ibbott has barely enough ads to cover expenses, and most podcasters work for free. Maybe a few of them will come up with a way to make a living doing it. Maybe not. Regardless, a trend is afoot that could transform the \$21 billion radio industry. Consider the basics: With no licenses, no frequencies, and no towers, ordinary people are busy creating audio programming for thousands of others. They're bypassing an entire industry.

The digital revolution took its time getting to radio. Now it's exploding—and the big bang goes far beyond podcasting. As radio shows are turned into digital bits, they're being delivered many different ways, from Web to satellite to cell phones. Listeners no longer have to tune in at a

certain time, and within range of a signal to catch a show or a game. As the business goes digital, the barriers to entry—including precious airwaves—count less and less. A host of new players is piling in. They include satellite-radio starts XM and Sirius, new-media giants such as Yahoo! and MSN, and regular folks like Ibbott.

Traditional radio powers are already feeling the pain. On Feb. 25, Viacom Inc. announced a \$10.9 billion write-down of assets at its Infinity Broadcasting Co. division, a clear signal that earnings prospects were dimming. A day later Clear Channel Communications Inc., the nation's largest radio chain, took a \$1 billion writedown on its radio licenses, though the company says it did so to comply with a new Securities & Exchange

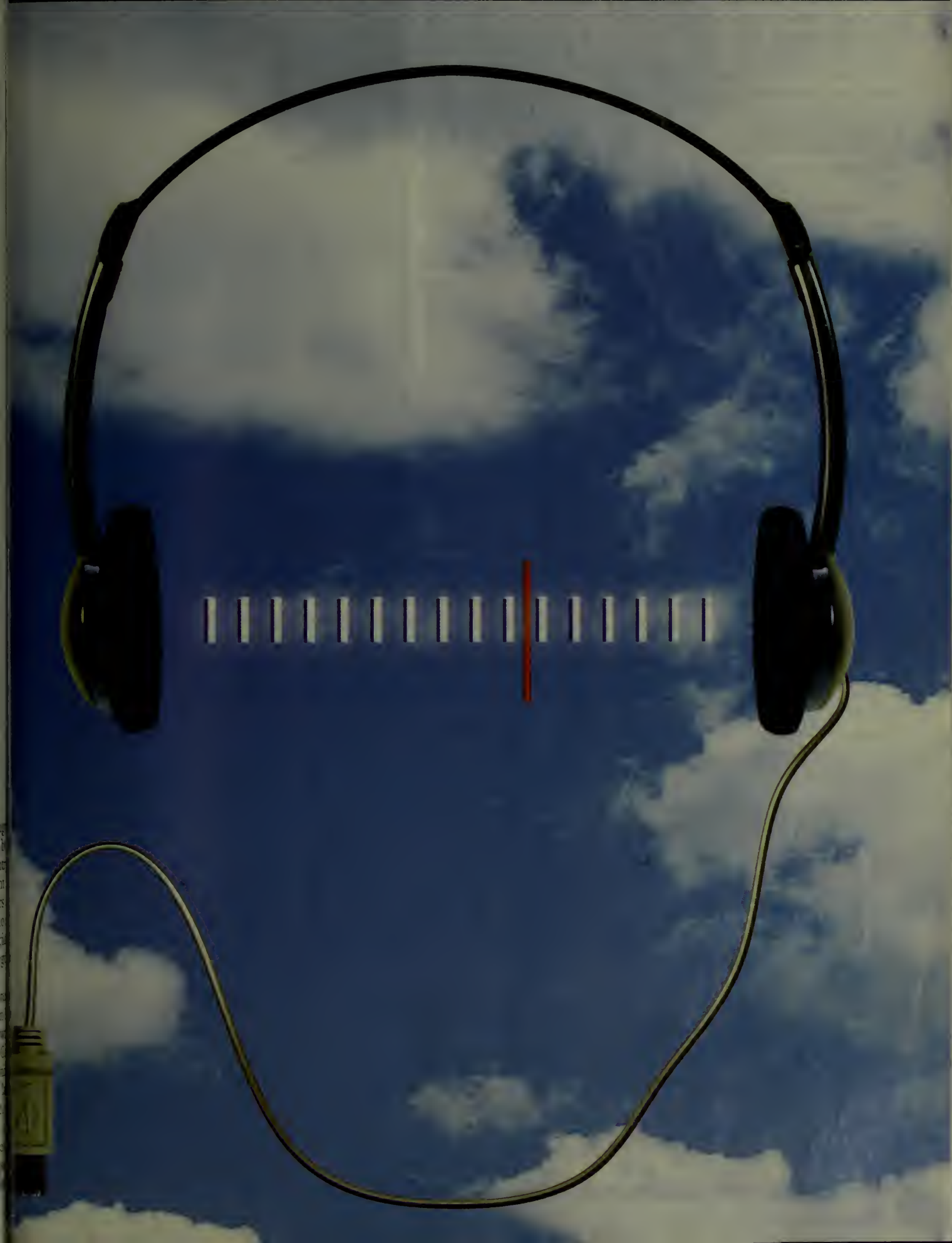
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Commission requirement to value its businesses. Whatever the reason, there's no denying a stark reality: Listeners, increasingly bored by the homogeneous programming and ever-more-intrusive advertising on commercial airwaves, are simply tuning out and finding alternatives. Says Rishad Tobaccowala, chief innovation officer at Publicis Groupe Media: "Radio pissed on their own product and then cluttered it up."

The industry tumult comes down to a simple phenomenon. As digital forms of radio proliferate, listeners will enjoy an abundance of new programming—but much of it still lacks a proven business model. What's more, even tested radio businesses could see ad revenues wither as new rivals snatch away listeners. No one is saying commercial radio is going away: It still draws more than 200 million listeners a week. The industry "is challenged, but not dead," says Laraine Mancini, an analyst at Merrill Lynch & Co. Still, the biggest fear, for old-timers and newcomers alike, is that even as audio programming grows by leaps and bounds, ad dollars will shrink.

BUYING A SONG

FOR RADIO TO MAKE money, execs must be as innovative with the business model as they are with technology. Satellite is losing money, but its subscription approach is expected to pay off in a couple of years. Now, Net radio players and cellular services are experimenting with subscriptions, too. It's possible to imagine people paying monthly fees to hear programming-on-demand on the phone, PC, or in the car. Listeners could buy a song they hear on the radio with the

Remaking Radio

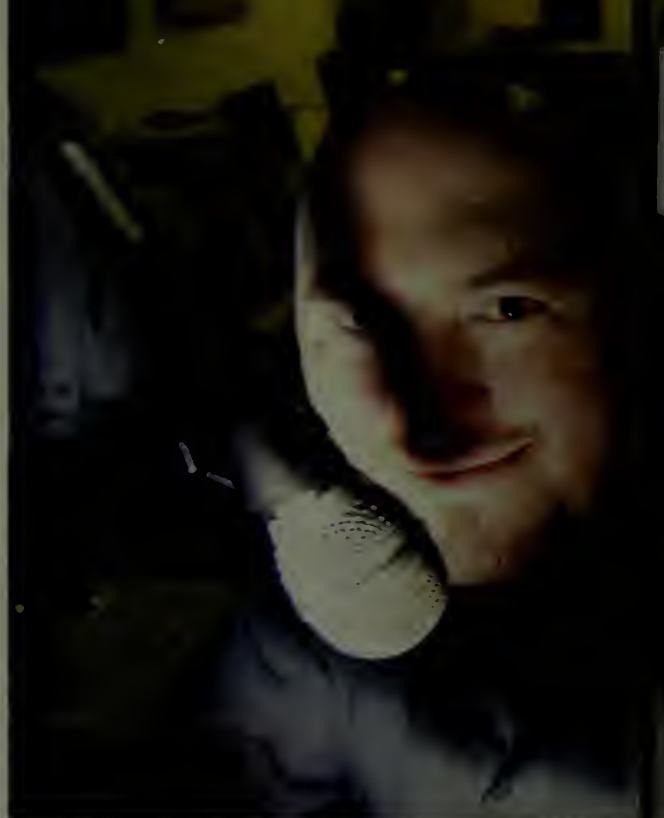
New technologies changed music. Now they're transforming the rest of the audio sector:

IBBOTT He has barely enough ads to cover expenses for his podcast *Coverville*

click of a button. Companies could sell subscriptions and place ads inside customized traffic information, weather reports, or sports tickers. "This is the tyranny of choice," says Fred Jacobs, founder of radio industry consultant Jacobs Media. "Companies need to rethink the competitive scenarios and take risks."

As old-fashioned radio struggles, listeners are creating the future. In just seven months, podcasts have appeared, covering subjects from Delta blues to vegetarian cooking to consumer gadgets. Podcasting is growing on the backs of two trends in the tech world: the proliferation of blogs—scores of which are becoming informal radio stations—and the growing popularity of MP3 players, including, of course, Apple's iPod. Much like television's TiVo Inc., podcasting gives users the chance to listen to their programming whenever and wherever they want it.

Already the forces of commercialization are circling. Entrepreneurs are offering software and services to help podcasters turn out more polished shows. Advertisers such as Volvo are sponsoring podcasts. And traditional radio stations, such as the British Broadcasting Co. (BBC) and National Public Radio (NPR) station WGBH in Boston, are launching podcasts. "One of the reasons to do this is because we don't know what it will add up to," says Ruth Seymour, station man-



ager at NPR station KCRW in Santa Monica, which on Mar. 1 began podcasting shows. For now radio stations are charging for podcasts, hoping instead lure more listeners nationally.

If podcasting is for now more of a potential threat to traditional radio, satellite is already drawing blood. While the players, Sirius Satellite Radio Inc. and Satellite Radio Holdings Inc., aren't expected to turn a profit until at least 2006, they have lined up high-priced programming talent and are making an aggressive play for the classic car-radio market. But drive-time radio isn't their only goal. They're stepping up marketing of handheld receivers that allow people to record shows and are placing programs on desktop programs such as Microso-

INTERNET RADIO

Eclectic programming and the proliferation of broadband have helped shows from leaders AOL, Yahoo, and MSN take off. Portable services from Cingular and Motorola are coming soon.

THE SKINNY With a weekly online audience of 19 million listeners, ad sales are up and traditional radio giants such as Infinity are moving online.

SATELLITE RADIO

XM and Sirius are taking advantage of listeners' dissatisfaction with traditional radio by offering commercial-free music and more than 120 channels each.

THE SKINNY Satellite is expected to attract about 35 million subscribers by 2010, up from roughly 4 million today. Many of those people would otherwise listen to terrestrial radio.

PODCASTING

New software lets amateur deejays and hobbyists create their own radio shows and offer them free over the Net. Listeners can download the shows onto MP3 players like the iPod.

THE SKINNY Over 3,500 podcasts now up from a handful six months ago. Their growing popularity could one day threaten traditional radio programming.



STERN Sirius spent big bucks for the shock jock, hoping he'll bring loyal fans

Clear Channel stations in the top 25 markets will introduce ad-supported sites offering radio feeds and studio performances from artists. Yahoo, MSN, and America Online have staked out an early lead by providing subscriptions and free services that allow people to customize music channels, skip through songs, and buy a tune as they hear it. "If we don't do these things online, people will go some-

2006 to 2.5% from 4%.

How is old-time radio responding to this assault? For starters, it's looking for ways to bring back listeners. With ads clogging airwaves, the average listening time per person has dropped by more than three hours, to just under 20

where else to get it," says Evan Harrison, hired from AOL Music to develop Clear Channel's Web strategy.

Not everything is easy for those taking the digital road. While audiences at the biggest Net radio players, including Yahoo and MSN, continued to increase last year, the total weekly online-radio audience was unchanged during the past six months, at around 19 million, according to a recent Arbitron survey. Why the plateau? Some companies limited the music people could hear online to avoid paying heavy royalties. To help foot the bill for those fees and boost the nascent industry, AOL, Yahoo, and MSN agreed last year to jointly seek advertisers for their online radio stations.

Radio execs argue that their innovations and adjustments in programming will put their business back on a sound footing. "We've gone through a lot of events in our history that were...all said to spell the demise of radio," says Jeffrey H. Smulyan, CEO of Emmis Communications Corp., a leading owner of radio stations. "I feel good about the radio business." On one point, he's right to be optimistic. Thanks to the new technology, more people than ever will be creating and listening to audio programming in coming years. But the radio industry, a members-only club for the best part of a century, is turning into a free-for-all. ■

—By Heather Green and Tom Lowry in New York and Catherine Yang in Washington, with David Kiley in New York

Media Player. "Satellite-radio companies at the beginning of their growth curve," says XM CEO Hugh Panero. Having raised comfortable piles of cash, XM and Sirius are investing to lure subscribers. Sirius spent \$500 million luring shock jock Howard Stern from terrestrial radio, hoping he'll bring loyal fans with him. Despite a rocky start, Lehman Brothers Inc. expects nearly 35 million people to tune in to satellite radio by 2010, up from roughly 4 million now. While only a fraction of the traditional radio audience, these defections could have a huge impact. Lehman Brothers analyst William Meyers estimates that since many satellite listeners listen during the daily commute, the most profitable hours, satellite alone will cut traditional radio revenue growth after

hours a week since 1993, according to industry monitor Arbitron Inc. Clear Channel and Entercom Communications Corp. are reducing the frequency of commercials and cutting them from 60 seconds to 30.

ON-DEMAND CONTENT

MORE PROFOUND CHANGES lie ahead as the radio majors join the digital fray. Their biggest hope is high-definition, or HD, radio, which provides CD-quality sound. By the end of the decade at least 2,500 stations are expected to have it. Radio execs are betting that HD will allow them to offer the kind of niche programming already available on satellite radio and on the Web. And in the next few years, HD will feature TiVo-like functions, enabling listeners to store music and news and get on-demand content such as traffic information, weather, and sports scores.

HD radio will keep traditional players in the fight. But getting traction will mean convincing carmakers to install the radios—and satellite has a head start in colonizing the dashboard. Cutting the price of HD receivers—now \$500 to \$1,000—will be crucial to attracting auto makers.

Even as they gear up for HD, the likes of Clear Channel and Infinity have discovered the Net. By this summer nearly 250

DEFINITION (HD) RADIO

Provides CD-quality sound and allows stations to have two digital and one analog station on the frequency, which could usher in more local or niche programming.

WHY Although at least 2,500 of the 13,000 commercial stations will be digital by 2010, the high price could limit HD's popularity: Receivers now cost \$500 to \$1,000 a pop.

BusinessWeek online For a look at a Web designer who's using the Web to make his deejay dreams a reality, please go to www.businessweek.com/extras

MANAGEMENT

THE SURPRISE PLAYER BEHIND THE COUP AT HP

Now Director Dick Hackborn could have a big hand in what comes next

AS HEWLETT-PACKARD Co. grapples with its transition following the Feb. 8 ouster of CEO Carleton S. Fiorina, much of the focus is on Patricia C. Dunn, the vice-chairwoman of Barclays Global Investors who replaced Fiorina as chairman of the HP board. But a key player in HP's ongoing saga lives in Boise, Idaho, far from HP's Silicon Valley home.

BusinessWeek has learned that Richard A. Hackborn, the board director who built HP's gold-mine printer business in the 1980s, carried out crucial behind-the-scenes roles in the months-long drama leading to Fiorina's sacking. Even more surprising, two insiders, one former and one current, say that Hackborn's doubts about Fiorina extend back to her early days at the company. "Almost from the time Carly was hired, Dick had his worries," says the former insider.

In the final weeks Hackborn was a key proponent of a plan to shift operating authority from Fiorina to HP divisional heads, says the current insider, adding: "Dick's criticism helped shape the views of other, often newer board members." Hackborn did not respond to requests for interviews, and HP and Fiorina had no comment.

The question now is whether the 67-year-old Hackborn will exert the same influence over the next CEO and the company's future strategy. While many Wall Street analysts want HP to separate the lucrative printer division from the rest of the \$80 billion outfit's computing divisions, the board says it plans to stick to its soup-to-nuts strategy. In the past, Hackborn felt that the computer businesses were too weak to stand on their own. If the next CEO disagrees, he or she will likely have to make the case to Hackborn.

Hackborn supported Fiorina's controversial bid to buy Compaq Computer Corp. in 2001. But he and other directors grew frustrated as HP's performance faltered in late 2004, says the current insider. Fiorina argued that the company was performing well, but Hackborn insisted that HP had to be far more aggressive about stemming market-share losses to IBM and Dell Inc. And in the weeks before her firing, "Dick's role was decisive and catalytic."

The current insider says Hackborn pushed for former Compaq and HP director Thomas J. Perkins to be reinstated to the board. That occurred on Feb. 7, just in time for Perkins to vote for Fiorina's ouster the next day. Two departures

HACKBORN Critics say he has moved HP away from innovation

tees from HP say Fiorina wanted Perkins off the board because he was more vocal and outspoken than other directors. Perkins retired from the board in 2004. *BusinessWeek's* attempts to reach Perkins by phone were unsuccessful.

For more than a decade, Hackborn operated as the power behind the throne at HP. When Hackborn refused the treaties of co-founders Dave Packard and Bill Hewlett to make him the CEO in 1992, he was put on the board. He played a key role seven years later in ushering out Lewis C. Platt, who had gotten the job in his stead. Now that Hackborn helped show Fiorina the door, he'll probably play a significant role as the company looks for her replacement.

Still, his reputation has taken a bruise. In the past, Hackborn was idolized as a legend by HP insiders and investors. Now, much like Fiorina, he has become a po-



ing figure, with a base of steadfast supporters surrounded by a community of critics. That's mostly because of his support for Fiorina and the Compaq deal, which has not been the success the computer giant hoped for. "I love Dick, but he screwed up," He should resign," says one longtime former colleague at HP. Other criticisms go even deeper. While Hackborn's visionary contribution in printers is undeniable, many wonder if he led HP in the wrong direction in the computer business—away from systems based on proprietary HP technology and toward more commoditized gear, such as Windows PCs, a market dominated by superefficient Dell. Some critics say Hackborn's influence has pushed HP away from its roots as an innovator and relegated it to being a distributor of less profitable products.

TECH HEAVYWEIGHT

HOW DOES HACKBORN maintain such power at HP? He has tech bona fides, a taste for power, and is at his best working in the shadows. There's no better example of this than the evolution of Hackborn's relationship with Fiorina. During their second one-on-one meeting, Fiorina argued that she should be CEO, with Hackborn remaining on as board chairman. The idea was that he would mentor her while she allowed him to remain in the background. And HP would gain credibility with investors by having Hackborn as chairman. Functioning as an adviser to Fiorina offered Hackborn both the influence and the profile he coveted.

"Dick's very political, but without really putting his skin in the game," says

Michael Maccoby, who wrote an exhaustive (and, at the time, anonymous) profile of Hackborn in a 1977 book called *The Gamesman: The New Corporate Leaders*. "He probably felt he could use Carly to do

Compaq board members in Boise a few weeks after fellow director Walter B. Hewlett launched his proxy fight to nix the deal.

Hackborn's anxiousness eased after the merger. But as HP began to miss its financial targets in 2003 and 2004, Hackborn "became increasingly outspoken," says the current insider. "Carly viewed [HP's performance] as getting better, requiring less urgency than the board viewed as necessary. Dick was a key figure in this debate."

In part because of his early support for Fiorina and the merger, board members took those doubts to heart. When Dunn presented a memo to Fiorina with a list of concerns before the board's January meeting, Hackborn was in the room, along with director George A. Keyworth III, a former Reagan White House adviser.

While still a power on HP's board, Hackborn remains one of tech's most elusive personalities. Author Maccoby highlights the contradictions in Hackborn's character in *The Gamesman*. While Hackborn is nonconfrontational, he is decisive and can be coldly calculating, say longstanding colleagues. "If you're on Dick's side, he'll do anything for you. But once he doesn't support you anymore, he won't confront you; he just won't defend you. He'll let you fail. I think Carly lost Dick two or even three years ago," says one such colleague.

Now that Fiorina is gone, will Hackborn's role at the company remain as critical as it has been in the past? His friends say he has wanted to retire from the board for some time. Still, if Hackborn is to fade from the HP scene with his reputation intact, he and his fellow board mates must find a CEO who finally puts the computer giant on a more profitable path—and ends the soap opera of recent years. ■

—By Peter Burrows
and Ben Elgin in San Mateo, Calif.



Within Fiorina's first year on the job, Hackborn was confronting her about her refusal to delegate, her extravagant promises, and the exodus of trusted execs



FIORINA
Too bold?

all the things he didn't want to do."

But within Fiorina's first year on the job, Hackborn fretted in board meetings about three issues, say sources: Fiorina's refusal to delegate operations, her tendency to make bold promises, and the exodus of trusted execs. "As Carly drove strong people out of the company, Dick got quieter and quieter" in HP circles, says longtime colleague Bob Frankenberg, who helped Hackborn build HP's PC business in the early '90s.

Like many, Hackborn was dazzled by Fiorina's salesmanship, but he was concerned about overpromising. "He'd say in board meetings: 'Carly, you shouldn't do that,'" says one former insider who was present at those board meetings.

Publicly and outside the boardroom, Hackborn continued to be her staunchest supporter. Just a year into her tenure he handed her the chairman's job. And during the 2001 fight over the Compaq merger—an idea he had proposed months before Compaq came calling—Hackborn agreed to publicly support the deal, and he lobbied key investors. To defend the merger, he even hosted a powwow of select HP and

Crumbling Alliance at Hewlett

Director Richard Hackborn started as a staunch supporter of CEO Carly Fiorina—but became a leading critic in her last year. Here's how the alliance chilled:

1999 Hackborn, builder of HP's printer business, takes key role in courting Fiorina, a top Lucent exec, to run HP. At her request, he chairs the board while she settles in.

2001 Fiorina launches controversial merger with Compaq. Hackborn, who earlier suggested the deal, helps rally support for the CEO.

2004 Outspoken venture capitalist Tom Perkins, a critic of Fiorina, retires from the board. Hackborn worries about market-share losses to Dell and IBM and urges the CEO to hire a strong operations exec. She resists.

2005 Hackborn helps bring Perkins back to the board—a signal to insiders that Fiorina is losing control. Increasingly unhappy with Fiorina's operations management, Hackborn is a decisive figure in her February sacking.

THE INTERNET

GOOGLE: A \$50 BILLION 'ONE-TRICK PONY'?

Its focus on Web-searching may be blinding it to big opportunities

EVEN GOOGLE INC. COULD not have predicted the value of a few lines of text. Search engine advertisements—typically a sparse 10 to 15 words in length—have almost single-handedly propelled the Web search giant's net sales up 468%, to \$2 billion, over the past two years.

And yet, a handful of analysts increasingly are questioning whether Google's laserlike focus on search may be something of an Achilles' heel. Google remains almost entirely dependent for growth on search—a business that's poised to slow. In the maturing U.S. market, Forrester Research Inc. predicts growth will drop from 45% to 30% this year.

The expected cooling-off prompted two analysts to downgrade Google's stock in February, helping to lower the price 5% for the month, to \$185. "Google is a one-trick pony," says Forrester analyst Charlene Li. "It's a nice trick, but it's all they do."

Of course, the stock is still up 121% since the August initial public offering; Google's market cap now tops \$50 billion. And executives remain confident that the text ads displayed around search results will continue to drive growth. They see plenty of room for expansion overseas, which accounts for more than half its searches but only a third of sales.

Google is also just beginning to entice big traditional advertisers to search. Of the world's 1,000 largest companies, Google can boast only 227 as advertisers. "It's very much an untapped market," Google Chief Executive Eric E.

Schmidt told analysts in February.

But Google's belief in search may be blinding the company to other opportunities. To see what they risk missing out on, Google execs need look no further than key rival Yahoo! Inc., which tirelessly looks for new business models. While search accounts for 45% of Yahoo's sales, the portal also snares one-third of its revenues from so-called display ads that contain graphics and multimedia, as well as 16% of sales from subscription services, such as online personals and fantasy football. By comparison, Google gleans 98% of its sales from text ads, primarily placed around search results.

THINKING SMALL?

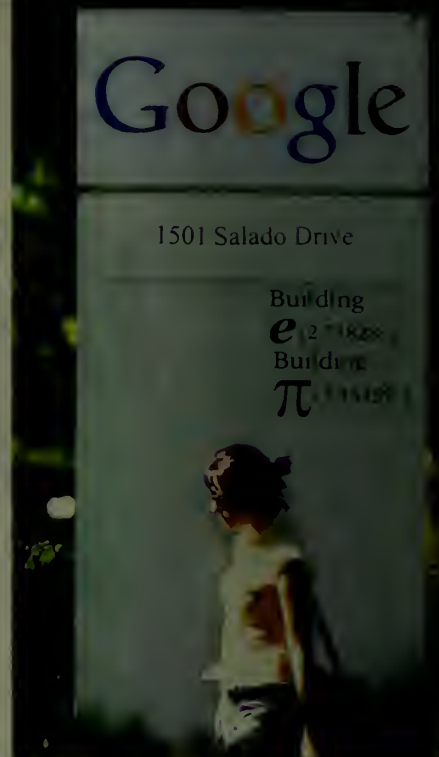
IT'S NOT AS THOUGH Google isn't investing in other businesses. Fully 30% of the money it spends on product development

goes into projects other than its bread-and-butter search business. Not bad, but most of these projects end up falling under its text-advertising umbrella.

Take Google's ballyhooed foray into e-mail, dubbed Gmail. Instead of charging users \$10 or \$20 per month for jumbo-size accounts, Google is delivering text ads alongside e-mail messages, targeted toward the content in the

e-mail. A message about an upcoming Boston Celtics game, for instance, might trigger ads from online ticket brokers. So even if targeted e-mail ads take off—a questionable proposition, since most industry observers believe e-mailers are far less likely to click on links than searchers—the money will come from the same budgets that buy the rest of Google's ads.

Meanwhile, one of Google's best shots



JUST BROWSING

An underachiever in display ads

at building a new revenue stream receives scant attention. Last May

company began experimenting with display ads—which run atop or along side of a Web page. It's enticing for advertisers who are often as concerned with building their brand as they are with driving traffic. But Google is loath to showcase such ads on its own site for fear of cluttering its spartan interface. Rather, it acts as an intermediary between content providers and relevant advertisers. For example, Google might make luggage advertisements from its network of customers with an online *New York Times* story about travel.

Still, 10 months after uncorking the service, Google is being strangely cloumouthed. It won't divulge specifics about the number of participating publishers or advertisers. And the topic came up just once during Google's four-hour meeting with analysts on Feb. 9. All this, while Yahoo's comparable business rocketed 39% in 2004, to \$857 million. "This is where Google has got to broaden out," says John Tinker, analyst at ThinkEquity Partners LLC. "Companies like Ford and General Motors are going to say, 'Search is great but let's get a little creative here.'"

Google, rightly, has plenty to tackle its core business of search. But there aren't the only opportunities for the search kingpin. Others deserve exploration, lest its narrow focus become a case of tunnel vision. ■

—By Ben Elgin in San Mateo, Ca

THE STAT

98%

Share of Google's 2004 revenues from online ads, up from 92% in 2002.

Data: Google Inc.



MARK LT

ARRIVE LIKE YOU MEAN IT.

lincoln.com

roducing the new 2006 Lincoln Mark LT. Announce your arrival with the
oaty baritone of a 300-hp, 5.4-liter V-8. Greet the world with a confident chrome
n. And step out ready to breathe new life into the term grand entrance.

Travel Well



LINCOLN

ENTERING
THE FRAY
CEO Novelli

LOBBYING

BY RAISING ITS VOICE, AARP RAISES QUESTIONS

It vocally opposes private accounts. But could its commercial interests create a conflict?

IN WASHINGTON, AN ENTITY'S power can be measured by the vehemence of the attacks it draws. By that standard, AARP may be outmuscled only by the White House in the slugfest over restructuring Social Security. The 35 million-member seniors' lobby has put its credibility on the line by opposing Bush's call for individual investment accounts carved out of Social Security payroll taxes.

Its high-profile opposition to those accounts has put AARP in the political bullseye. In one far-fetched attempt to drive a wedge between AARP and its members, the conservative group USA Next has posted an Internet ad accusing the organization of endorsing gay marriage while

failing to support U.S. troops. Some also see AARP's opposition to diverting Social Security funds to private accounts—which it criticizes as too risky—as the height of hypocrisy. Says American Enterprise Institute scholar James K. Glassman: “They are selling mutual funds, which by any conventional standard are far riskier than anything anybody has contemplated” for Social Security.

At the same time, AARP's role in the Social Security debate has focused new attention on the hundreds of millions of dollars the group makes by endorsing and co-branding health insurance, financial products, and travel services that are sold to its members. Some of those products suffer from lackluster performance, particularly the mutual funds it co-

brands with Scudder Investment unit of Deutsche Bank. As a result, AARP is considering an overhaul of mutual-fund program, *BusinessWeek* learned. Sources say the group even replace Scudder for some or all of its offerings.

Just as important is the question whether a group that makes millions of dollars from financial services to its members is quite as impartial a player in the debate over private accounts as it would appear. While wearing its policy hat, AARP, headed by CEO William D. Novelli, presents itself as a nonpartisan organization serving the interests of its over-50 members. But there's little doubt that most do not vote to see any change to the current system for fear of benefits cuts.

But it is equally clear that AARP makes a substantial sum of money from its partners' sales of mutual funds

Plenty of Partners

Most of AARP's revenue comes from co-branding with the likes of Scudder Investments and UnitedHealth Group. Here's how its business breaks down:

SERVICE	HEALTH INSURANCE	AUTO & HOME INSURANCE	TRAVEL SERVICES	LIFE INSURANCE
REVENUE (MILLIONS)	\$177	\$76	\$14	\$11
Data:				

her investment products to members. That raises the appearance of a potential conflict of interest. Whatever version of the reform passes—whether Bush’s accounts carved out from payroll taxes, or the “add-on” accounts that many liberals favor to encourage retirement savings—the overhaul is likely to create new markets and opportunities for some suppliers of financial products and lead to diminished opportunities for others. AARP has a stake in that debate. Unlike financial firms, however, AARP has the flexibility to drop waning products and team up with other partners on any new alternatives that emerge.

PROFITS SUPPORT SERVICES

AARP OFFICIALS reject the criticisms. The organization’s marketing “does not in any way influence AARP’s public positions,” says Dawn M. Sweeney, president of AARP Services Inc., the for-profit subsidiary that manages AARP’s co-branding deals. And, Sweeney adds, while AARP objects to diverting payroll taxes to the stock market, it supports private investing outside of Social Security. AARP is not opposed to private accounts,” says Sweeney. “We are opposed to private accounts that drain money out of Social Security.” AARP also says it pours all of its commercial profits back to advocacy and assistance for the elderly, providing member services such as driver’s education and free legal and tax advice.

Still, the scale of AARP’s commercial activities is enormous. The nonprofit is one of the nation’s most aggressive in selling its name to marketers of financial and travel products. In 2003, the latest year for which financial reports are available, AARP collected \$300 million—or 9% of its \$770 million in revenue—by co-branding with companies such as Scudder, UnitedHealth Group, and New York Life. AARP hauls in \$142 million in fees from the sale of Medicare supplemental insurance, almost \$76 million from the sale of auto and home insurance, and almost \$12 million from life insurance, followed by about \$7 million in mutual-fund fees.

This isn’t the first issue in which questions have arisen over whether AARP’s

commercial interests may conflict with those of its members. In 2003 it backed Bush’s controversial plan to remake Medicare. Liberals claimed AARP’s support was driven more by its interest in selling Medicare insurance than by the interests of its members. AARP strongly denied the allegations.

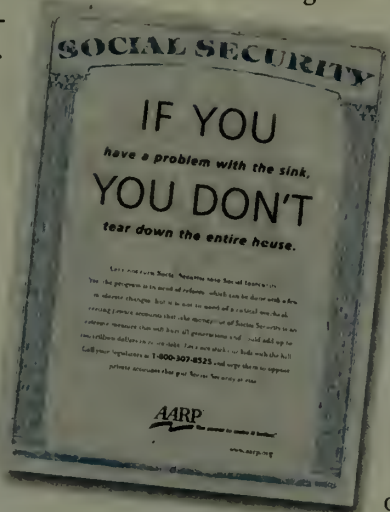
If critics have focused on its policy role, AARP has received less scrutiny for the quality of its products. Many of the funds and insurance policies that AARP markets provide considerably less benefit than seniors could get on their own, a *BusinessWeek* analysis reveals. Some of its insurance products charge high premiums compared with those of rivals. And many of the 38 funds Scudder markets through AARP offer average performance at best. Over both the last year and the last three years, only one Scudder-AARP fund delivered returns ranked in the top 20% of its asset class, according to mutual-fund researcher Lipper Inc. Similar conclusions were reached by two other independent firms that rate mutual funds, Morningstar Inc. and Standard & Poor’s, a unit of The McGraw-Hill Companies, which also owns *BusinessWeek*.

The Scudder-AARP Standard & Poor’s 500-stock index fund is typical, rated three stars by Morningstar and S&P. Relative to similar funds, “the fund has both fairly average returns and fairly average risk,” says Morningstar. The fund’s fee structure is also middle-of-the-road, with an expense ratio of about 0.4%—twice that of rivals such as Vanguard Group Inc., which charges 0.18% for its S&P 500 index fund, but well below the 1.16% average for all similar funds.

Morningstar warns investors to avoid all Scudder funds, largely because of what it believes are unresolved issues around rapid trading of some of its global fund shares. (Morningstar notes that Deutsche Asset Management stopped

the practice in 2003.) Deutsche Asset Management responded in a statement: “While we respect Morningstar, we disagree with their opinion in this instance.”

The funds do have some advantages tailored to AARP’s constituents, many of whom have limited assets. For instance, taxable accounts can be started with an initial investment of just \$1,000, with minimum additional investments of \$50, far below many funds. Still, sources say mediocre returns have AARP reconsidering its relationship with Scudder.



MUSCLE AARP is mounting an ad campaign against private accounts

AARP has asked an independent panel to review the funds. Sweeney will not comment on specifics. “We are constantly reassessing and looking at the competitive landscape,” she says.

A much bigger source of AARP revenue is insurance. The group’s supple-

mental Medicare “Medigap” insurance brought in \$142 million—nearly half of the total royalties Medicare received in 2003 for the use of its name and membership list. Those policies are widely regarded as good values. But many of AARP’s other insurance products fall short of the industry’s best. For example, the life policy that AARP co-brands with New York Life Insurance Co. provides a maximum \$50,000 in coverage. The monthly premium for a 10-year term policy for a 54-year-old nonsmoking male who lives in Maryland is \$49.52. Similar policies are available for less. AARP says its policies are designed for low-income people who have trouble buying life insurance. The New York Life policy has lower underwriting standards than most, making the policy easier to purchase but also a higher risk for the insurer—thus, more costly.

AARP’s Sweeney says the group is looking to extend its brand further by allowing outside partners to sell new services to members. But if AARP is going to avoid criticism, it will have to work harder to provide them with the best value for their money. ■

—By Howard Gleckman and Mike McNamee in Washington and David Henry in New York

CREDIT CARDS

\$11

MUTUAL FUNDS

\$7

OTHER FINANCIAL SERVICES

\$3

TOTAL

\$300

COMMENTARY

BY CATHERINE ARNST

Another Ailing Miracle Drug

Biogen's troubles with Tysabri are a setback for immune-system treatments

WHEN THE immune system goes bad, it goes very, very bad. Some 80 known diseases are caused by out-of-control immune cells that attack the body's own organs—among them multiple sclerosis, rheumatoid arthritis, type 1 diabetes, asthma, psoriasis, and Crohn's disease. For more than a decade, the pharmaceutical industry has been trying to come up with drugs to hold wayward immune systems in check. The recent experience with Tysabri, the breakthrough multiple sclerosis drug from Biogen Idec Inc. and Elan Pharmaceuticals Inc., shows the perils of tampering with the body's defenses.

A variety of immune-modulating drugs are now in the pipeline, and the need for them couldn't be more urgent. But this class of drugs, perhaps more than any other, requires that both manufacturers and regulators be extra-vigilant in monitoring for deadly side-effects—and in educating patients about the dangers.

It's possible Tysabri can still be saved. Approved by the Food & Drug Administration last November, it is the first new MS drug in more than a decade and is a "fantastic advance," according to Dr. Aaron Miller, chief medical officer at the National Multiple Sclerosis Society. When Biogen and Elan pulled it from the market on Feb. 28 after learning that two patients had developed a rare brain disease, fatal in one case, Miller and others in the field were saddened. The company and the FDA are seeking ways to reintroduce Tysabri safely, but Miller notes that it will be extremely difficult to screen out patients vulnerable to brain infections.

The problem is that the mechanism that makes Tysabri such an effective MS fighter may also turn it into a traitor. MS occurs when immune cells mysteriously run amok, attacking the myelin sheath that protects nerve fibers. Tysabri blocks roving immune cells from entering the brain. But in at least two patients who took the drug in combination with an older MS treatment, it apparently exposed the brain to the ravages of a common virus called JC.

Virtually all drugs that target the immune system leave the body susceptible to infections, and this yin-yang has tripped up a number of promising treatments in the past. Often, as with Tysabri, the infections didn't become manifest until patients were on the drugs for years. That's a bad omen for newer immune-targeting drugs, given the risk-averse climate surrounding drug development. "You will need to study a larger number of patients over years of therapy," warns Viren Mehta at investment advisor Mehta Partners LLC. The high costs of such large-scale human testing could seriously impede this area of cutting-edge research.

That would be a harsh setback for patients. The American Autoimmune Related Diseases Assn. estimates that one in every five people in the U.S. suffers from such an illness. Yet

there are few effective treatments. The most common MS drug right now is interferon-beta, which leaves patients exhausted by flu-like symptoms.

The good news is that the pharmaceutical industry has continued to identify autoimmune diseases as one of the largest unmet needs in medicine. BioPortfolio Ltd., a British market researcher, estimates that annual sales of autoimmune drugs based on biotech could triple by 2008, about \$20 billion.

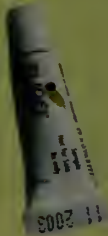
The market will grow, in part, because patients suffering from these chronic and often painful diseases are often willing to accept a good deal of risk for an effective treatment. The fact has been proven by the success of Amgen's Enbrel, Johnson & Johnson's Remicade, and Abbott Laboratories' Humira, a rheumatoid arthritis drug.

Meddling with Mother Nature

Drugs aimed at correcting autoimmune diseases often have unforeseen impacts:

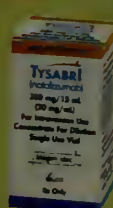
ECZEMA

Elidel and Protopic, from Novartis and Fujisawa, respectively, may increase the risk of lymphoma.



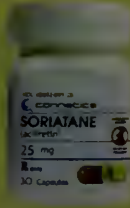
MULTIPLE SCLEROSIS

Biogen suspended sales of Tysabri because it may trigger a deadly neurological infection.



PSORIASIS

In 2003, Roche placed a warning about depression on the label of its Soriatane psoriasis drug.



RHEUMATOID ARTHRITIS

Enbrel, Remicade, and Humira, from Amgen, J&J, and Abbott, respectively, may boost the risks of tuberculosis and lymphoma.



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whose sales topped \$5.5 billion last year despite a long roster of side effects. All three block tumor necrosis factor (TNF), a protein produced during the inflammatory process that leads to the breakdown of bone and cartilage. The three drugs represent a major advance against this debilitating disease, but all leave patients more susceptible to tuberculosis and respiratory infections, and there are concerns that they increase the risk of lymphoma and worsen heart failure.

There are many immunomodulating drugs in the pipeline that have yet to show problems. Bristol-Myers Squibb Co. is seeking FDA approval for Abatacept, a rheumatoid arthritis treatment that shuts down an immune signal that triggers inflammation. And La Jolla Pharmaceutical Co. is testing Riquent, a lupus drug that blocks damaging antibodies. The drug received an "approvable" letter from the FDA last October, with the final nod contingent on the success of further clinical trials.

There is also hope that immunomodulators will ultimately be able to treat more than one disease. Rituxan may be the first to prove the point. The drug, jointly developed by Biogen Idec, Genentech, and Roche Holdings, was approved a decade ago for non-Hodgkin's

lymphoma. It blocks a potentially dangerous immune-system B cell, and is in late-stage clinical trials against rheumatoid arthritis.

Such multiple uses are just what doctors had expected for Tysabri. Before being pulled, the drug was in clinical trials against rheumatoid arthritis and Crohn's disease, a bowel disorder. Biogen has not given up on the drug, and has set up meetings with a number of medical specialists to figure out a way to minimize its dangers. It is hoped that any lessons learned will be useful for other drugs in this class. Patients will then at least have options, imperfect though they may be. ■

—With Amy Barrett in Philadelphia and John Carey in Washington

BusinessWeek online For a look at how Tysabri interacts with the immune system, go to www.businessweek.com/extras

ENERGY

OIL STOCKS: ONLY PATIENT INVESTORS NEED APPLY

Inventories are up, and prices are likely to fall—not a recipe for quick profits

LIKE TEXAS WILDCATTERS, stock market investors have charged into the oil sector this year—and they've hit a gusher of profit. While the overall market has gone nowhere since the start of the year, since the start of the year, shares in ExxonMobil soared 22% through Mar. 2, while ChevronTexaco rose 18%, BP 11%, Royal Dutch/Shell Group 10%, and France's Total 8%. Those are only the latest surges in a two-year rally that has sent the collective market capitalization of the oil world's Big Five up a phenomenal 72%, to \$1.14 trillion, since early 2003.

All that has raised questions about whether a bubble is forming in energy stocks. Vanguard Group was so concerned about piling on that it closed its Energy Fund to new accounts in December for a "cooling-off" period after it had racked up a 55% annual return.

So is Big Oil still worth owning? For long-term investors, probably yes. Stock prices aren't as high as they would be if investors really thought

today's high oil prices were here to stay. Michael Mayer of Prudential Equity Group uses historical patterns to project how much oil companies can expect to earn at any given oil price, and what stock prices should be based on those earnings expectations. By that analysis, he figures investors are braced for oil prices to drop gradually to below \$30 a barrel by 2007. That's plenty cautious, considering that crude hit \$52 a barrel on Mar. 2, and Saudi Oil Minister Ali Naimi said as recently as Feb. 24 that he expected prices to range between \$40

and \$50 a barrel for the rest of 2006.

Stock prices also look moderate in relation to expected earnings of oil companies. Thomson First Call says that price-earnings ratio of the sector, based on analysts' predictions of 2005 profits, is 14, vs. 16.4 for the overall Standard & Poor's 500-stock index. The only sector with a lower forward p-e is finance.

In contrast, momentum players looking for a quick kill had better watch. With stockpiles of crude and gasoline rising, there's a good chance that prices will fall at least a little. And history shows that in the short term, when crude falls, stocks also fall. Going back to 1989, Prudential's Mayer found that

stocks underperformed the Standard & Poor's 500 in 29 of the periods when oil prices fell 15% or more. "All energy's going to have short-term pullbacks," predicts John P. Herlihy Jr., a Merrill Lynch & Co. analyst and a long-time bull on oil stocks.

That's because supply is exceeding increased demand, despite strong economies in China and the U.S. and troubles oil producers from Russia to Iraq to Nigeria. The Energy Dept. says

that as of Feb. 25, U.S. crude inventories were up 9% from the year before, while gasoline supplies, despite a worrisome drop in refinery usage, were up 10% above their five-year averages.

Hot money from hedge funds and other sources has flowed into oil this year, both chasing the rise in stock prices and contributing to it. But those momentum investors could abandon oil at the first sign of trouble. So while oil stocks look good long term, don't count on capital gains to keep gushing this year. ■

—By Peter Coy in New York

THE STAT

\$1.14 TRILLION

Market cap of the five biggest oil companies, up 72% over two years*

*Includes ExxonMobil, BP, Royal Dutch/Shell, Total, and ChevronTexaco

Data: Standard & Poor's Capital IQ

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SUSTAINABLE?
Visteon's glass
plant in Nashville

AUTOS

A WRENCH FOR PARTS SUPPLIERS

Labor and legacy pension costs from GM and Ford are hurting Delphi and Visteon

BACK IN 1999, GENERAL Motors Corp.'s plan to spin off the Delphi parts division looked like an all-around great idea. By carving out its components business, GM reckoned to shed nearly 43,000 union workers and trim supply costs. To make Delphi attractive to investors, the auto giant blessed it with a clean balance sheet and billions of dollars in contracts. If Delphi could cut costs and win sales from other carmakers, executives figured, it would prosper.

That expansive vision proved short-lived. Both Delphi Corp. and Visteon Corp.—spun off from Ford Motor Co. in a parallel exercise in 2000—have been unable to repeat their initial profit bursts after the spin-off. And now, as domestic auto makers face deep cuts brought on by their own sales declines over the last several years, the pressure is getting worse. With sales at GM and Ford down again in February—for the second straight month—Ford will slash production 10% in the first quarter, and GM plans equally deep cuts in the second. That means more trouble for Delphi and Visteon, which still sell about 50% and 70% of output, respectively, to their former parents. Hamstrung

by a legacy of hefty labor and retiree costs, shares of both are off 30% in the past 12 months, to less than \$7 a share.

Delphi and Visteon are grabbing new business and diversifying. But to survive, they must speed efforts to cut costs and shed bad businesses. “Neither is sustainable in the current form,” says David Leiker, senior auto analyst at Robert W. Baird & Co. in Milwaukee.

Like other parts makers, Delphi and Visteon have been battered by rising commodity prices. But labor is their main problem. Thanks to their ties with GM and Ford, the two pay most of their United Auto Workers employees wages and benefits totaling about \$70 per hour. That’s equal to pay at car plants—and up to 60% more than at rival suppliers such as Johnson Controls Inc. and Lear Corp. Delphi’s 185,000-strong global workforce includes some 25,000 UAW members in the U.S., while Visteon employs 18,000 UAW members.

Factory closings don’t offer an easy so-

lution. UAW contracts require union approval for shuttering a plant. The company would also have to transfer affected workers, rather than let them go. The only way either could fully shed the high-paying workers would be to buy them out—with losses piling up, that’s a costly option. Instead, idle workers at both companies draw some 90% of their salary and benefits. J.T. Battenberg III, Delphi’s chairman and CEO, figures that’s about \$130,000 a year for a worker. So, if Delphi keeps all 3,000 of its recently laid-off workers idle for a year, “that’s \$390 million off the bottom line,” says Battenberg, who announced he’ll retire this year. Analysts say Delphi should hire an outsider, since a non-GM veteran might be better at developing new mar-

ASIAN THREAT

THE SUPPLIERS’ CURRENT contracts make it tough to grow at home. Big Toyota purchasing agents use the threat of lower-priced Mexican and Asian parts to win lower cost contracts. And in the U.S., Japanese and Korean auto makers simply won’t buy parts from union plants.

Meanwhile, mounting retiree costs are adding to the pain. Following a \$600 million pension contribution it will make this year, Delphi will have to add a further \$1 billion. It may sell assets worth \$400 million to avoid eating into its \$1 billion cash reserve. Since sales to GM and Ford have slackened, Delphi has borrowed heavily to cover rising health-care costs and Visteon suspended its dividend last month.

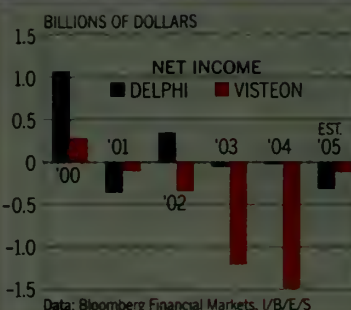
The question is whether the two companies can build new business and restructure old units fast enough to stave

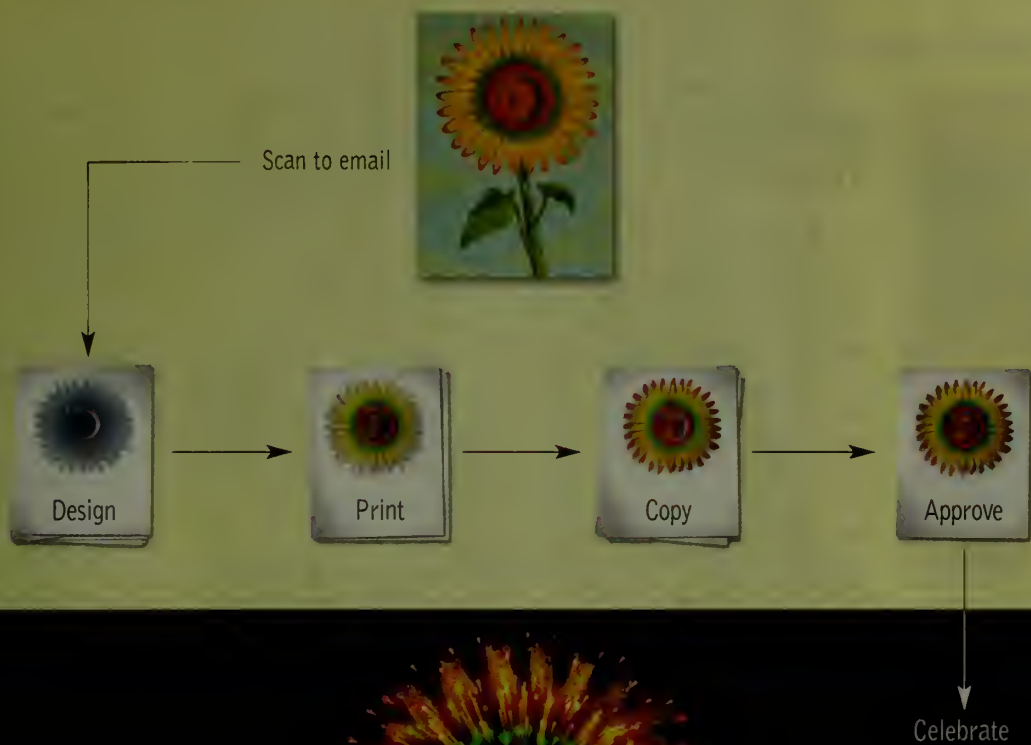
a full-blown financial crisis. Delphi expects to earn \$100 million this year from its auto-parts operations in China, where Visteon also is growing. Both parts makers are pushing harder in electronics and satellite radio. But none of that will be enough to cure what ails both companies. Visteon

is negotiating with Ford to help it sell nonperforming businesses like auto glass and chassis, which account for 30% of revenue but up to two-thirds of its union work force. Battenberg says Delphi, too, has a list of weak operations to sell. If the way Ford and GM are headed, they had both better move fast. ■

—By Adam Aston in New York and David Welch in Detroit

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HEADLINER

MICHAEL CHERKASKY



MARSH IN THE MIRE

Michael Cherkasky took control of beleaguered insurance broker Marsh & McLennan in October—not long after New York Attorney General Eliot Spitzer hit it with a suit alleging bid-rigging and other fraudulent activities. Since then there has been a board shakeup, and several key execs have been axed.

But Cherkasky's troubles aren't over. On Mar. 1, Marsh Mac announced a steep quarterly loss, stemming largely from the \$850 million payment to settle the Spitzer suit. It also announced plans to halve its dividend—and a restructuring that could eliminate up to 2,500 jobs. Most of the cuts will be in its brokerage unit, Marsh Inc., and could result in annual savings of more than \$375 million, Cherkasky said.

"We are trying to be realistic about a very tough year and where we're going to come out of it," he told investors. Still, Marsh employees should get some solace: In May the company plans to ask shareholders to replace about 40 million worthless stock options with new ones.

—Marcia Vickers

MCI KEEPS TALKING

The final showdown between Qwest Communications International and Verizon Communications for control of MCI is about to begin. On Mar. 2, Verizon granted MCI a two-week window to talk with Qwest, after Qwest revised and upgraded its previous offer for the nation's second-largest long-haul carrier. The move comes after MCI accepted a \$6.75 billion bid from Verizon on Feb. 14, spurning an \$8 billion offer from Qwest. After MCI shareholders balked and Qwest CEO Richard Notebaert asked MCI to explain why it preferred Verizon's offer, the MCI board decided to ease the strain by talking with Qwest again, even as it signaled that Verizon remains the favored suitor.

JPMORGAN'S CASTAWAY



Now that its private-equity arm is minting money, JPMorgan Chase has decided to spin off the unit by the end of next year. Although JPMorgan Partners, which manages \$13 billion, reported \$1.4 billion in profits last year, it has contributed to big swings in earnings. Chief Operating Officer Jamie Dimon noted that the unit's appetite for

bigger deals could lead to conflicts with customers such as buyout firms Kohlberg Kravis Roberts and Blackstone Group. JPMorgan still will hold a 65% stake in the \$6.5 billion global fund and will contribute up to \$1 billion more in 2007. Meanwhile, JPMorgan will use One Equity Partners—inherited from the January, 2003, merger with Bank One—for private-equity investments.

TITAN TAKES A LICKING

San Diego defense contractor Titan will pay \$28.5 million to settle criminal and civil charges that its payments to win business in Benin violated U.S. anti-bribery laws. The payout was the biggest ever by a company to run afoul of the Foreign Corrupt Practices Act. Titan pleaded guilty in federal court on Mar. 1 to three criminal charges and will pay a criminal fine of \$13 million. It also agreed to pay a \$15.5 million penalty to the Securities & Exchange Commission, without admitting or denying wrongdoing. The SEC had alleged that Titan paid more than \$3.5 million from 1999-2001 to an agent in Benin, who funneled about \$2 million to the President's reelection campaign.

CONTINENTAL FLAIR

To the delight of investors, Continental Airlines on Feb. 28 announced tentative deals with its pilots, flight attendants, and mechanics to cut wages and benefits at the end of March. If the deals are approved by workers, the airline is expected to hit its \$500 million annual labor savings target. Workers will

receive 10 million stock options as part of the agreements. Robert Asher of UBS figures that the agreements would put Continental's pilot pay in middle of the pack among U.S. peers. Continental shares rose 14%, to \$12.18 on the news.

ET CETERA...

» General Electric expects most of its growth to come from developing countries the next decade.

» AutoZone's quarterly earnings rose 30%, thanks strong sales and a tax benefit.

» Halliburton said it knows no antitrust violations after disclosing a Justice probe of possible bid-rigging.

CLOSING BELL

Shares of **Chiron** rose 6.4%, to \$37.69, on Mar. 2 after British regulators cleared its Liverpool plant to make flu vaccines for the 2005-2006 flu season. Last October the plant was shut down due to contamination, causing a fourth-quarter loss of \$22.9 million.



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EDITED BY RICHARD S. DUNHAM

Maybe the Neocons Were Right After All

JUST A FEW MONTHS AGO, the intelligentsia from Boston to Berlin was mocking President George W. Bush and his neoconservative advisers as naive ideologues whose vision of spreading democracy throughout the Islamic crescent was going up in the flames of Iraq and Israel. That was then. Now, after successful Iraqi

and Palestinian elections, baby steps toward reform in Saudi Arabia, an opening in Egypt, and peaceful demonstrations against the Syrian occupation of Lebanon, administration critics are all but conceding that Bush may be on to something. "Despite all the numskull comments and lack of understanding of the area, you have to say there is good as well as bad," says one pro-Israel-based Western diplomat.

While happenstance has helped—Yassir Arafat's death, for example, restarted the peace process—some experts are beginning to credit a relentless America, too. Bush has succeeded in shaking up the "order," says Middle East expert Eyal

son of Tel Aviv University. Indeed, now that Bush has won a second term, both longtime allies and stubborn satraps have been forced to face the fact that they'll have the hardheaded president to deal with for the next four years. Secretary of State Condoleezza Rice, who attended a Mar. 1 meeting in London on the future of the Palestinians, has tapped into the new reality by winning expanded commitments from NATO allies to train Iraqi security forces and from France to tighten the diplomatic screws on Syria.

But the White House has a long way to go before the seeds of democracy bear fruit. Among the challenges:

WINNING THE IRAQI PEACE. Majority Shiites must let minority Sunnis take part in governing, and the U.S. must make more Iraqi forces combat-ready to pave the way for a graceful exit.

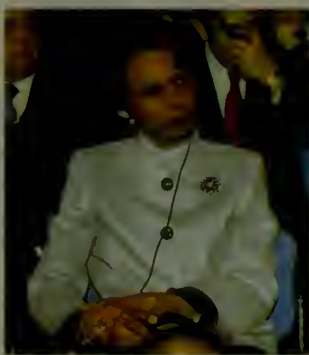
ENCOURAGING ABBAS. Bush was roundly criticized in Europe for his low-key ap-

proach to the Israeli-Palestinian deadlock. But the election of reformist Palestinian President Mahmoud Abbas gives the White House reason to hope. Bush's challenge is to gently nudge Israeli Prime Minister Ariel Sharon toward withdrawals from occupied territories while pushing Abbas and Syria to crack down on terrorists. The U.S. has handled Abbas well, "largely by not appearing to embrace him too closely," says Jon B. Alterman, a Middle East expert at the Center for Strategic & International Studies. It will take deft diplomacy to sustain the fragile momentum.

WOOLING THE ARAB "STREET." Recent events shattered the view that most Muslims reject American concepts of liberty and democracy. They're "starting to question the status quo in the region," says David Makovsky, a senior fellow at the Washington Institute for Near East Policy. "This gives the President a chance."

By working with Mideast reformers and nongovernmental organizations, the Administration may be able to promote incremental change. The goal: allowing democracy to flower while marginalizing radical Islamic groups—Hezbollah in Lebanon, the Muslim Brotherhood in Egypt—that might do well if elections were held today. "Everything in the past few months is just hopeful beginnings that could change overnight," warns Gerald M. Steinberg, a conflict expert at Israel's Bar-Ilan University. That's no doubt true. But just yesterday the neocons weren't given even a glimmer of hope. ■

—By Stan Crock, on the road with the Secretary of State, with Stanley Reed in London and Neal Sandler in Jerusalem



NEW REALITY Rice has leaned on reluctant NATO allies

CAPITAL WRAPUP

WASHING CABLE'S MOUTH OUT?

SENATE Commerce Committee Chairman **Ted Stevens** (R-Alaska) just complicated his plans to rewrite the 1996 Telecom Act. At a Mar. 1 broadcast industry meeting, he expressed interest in extending to cable TV the anti-indecency regulations that govern network broadcasts. Cable execs, who have reaped huge profits from foul-mouthed and risqué shows such as *The Sopranos* and *The L Word*, will now redouble their efforts to resist any wide-ranging rewrite of the landmark telecom law. Unlike the political environment preceding the 1996 act, when the phone, cable, and broadcast sectors all wanted a change in the rules, today only the **Bells** are pushing for a rewrite that would offer greater deregulation. In addition to cable's new indecency worries, broadcasters fear a legal overhaul would include restrictions on their consolidation efforts.

POSTPONEMENT DIPLOMACY

USUALLY, DIPLOMACY means quiet discussions between countries that have differences. But **Secretary of State Rice** is taking a new tack—no-show diplomacy—that seems to get results. After she abruptly canceled a trip to Egypt to signal her displeasure at the jailing of a political dissident, President **Hosni Mubarak** promptly moved toward competitive presidential elections for the first time. Then Rice put off a visit to Canada after Ottawa declined to join the U.S. missile defense program. One Administration official says Canada's decision was a factor; another insists the proposed April date just didn't work. But the message delivered was: It's Condi time.

VENEZUELA

KILLING THE GOLDEN GOOSE?

Chávez is harming the oil industry to feed his social programs

MARIA CONCHITA Carrillo didn't learn to read and write as a child because her mother couldn't afford to send her to school. But in June the 77-year-old former seamstress will complete sixth grade, courtesy of Petróleos de Venezuela (PDVSA). Venezuela's state-run oil company doesn't just pay for Carrillo's schooling. It foots the bill for a new community health clinic where she can get free medicine, and it subsidizes the rice, cooking oil, and other staples she buys at government-run stores. "It's the first time that the government has ever done anything with our oil wealth to benefit the poor," says Carrillo, sitting in an improvised classroom in a poor barrio in Caracas.

Venezuela's oil riches have long been a curse as well as a blessing. The country boasts the largest petroleum reserves outside the Middle East. For the better part of a century the commodity has fueled the local economy—along with the ambitions of politicians. Now, President Hugo Chávez, a left-leaning populist who draws inspiration from independence hero Simón Bolívar, is reaching deep into PDVSA's coffers to finance a "democratic revolution" to raise millions of Venezuelans out of poverty. Chávez is pumping some \$4 billion of PDVSA's windfall profits into social programs each year. At PDVSA's headquarters in Caracas, a mural depicts Chávez and a child superimposed on an oil well, with the slogan: "Deepening the Bolivarian Revolution in 2005."

Turning petrodollars into good works? Sounds laudable. But Chávez is also using oil in his bid to turn Venezuela into a

counterweight to U.S. influence in Latin America. Venezuela, once a dependable American ally, has become a thorn in Washington's side. The White House takes a dim view of Caracas' sales of subsidized oil to Fidel Castro's Cuba. It's also none too thrilled that Chávez is using petrodollars to outfit his army with Russian-made Kalashnikov rifles, combat helicopters and MiG fighter jets.

Ever since the Bush Administration appeared to endorse a short-lived coup d'état against Chávez in 2002, the Venezuelan leader has accused Washington of trying to oust him. In a Feb. 20 TV appearance he warned that George W. Bush plans to have him assassinated. If that happens, he warned, the U.S. will not receive another drop of Venezuelan oil for a 1,000 years.

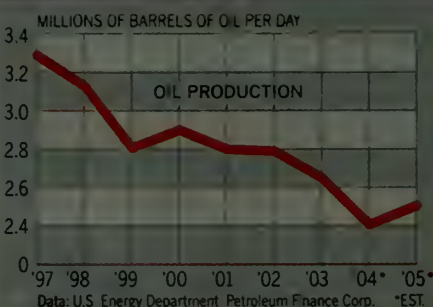
Some of this is bluff and bluster. But Chávez knows he has oil-guzzling America in a corner. The U.S. depends on Venezuela for 15% of its oil imports, and when a strike at PDVSA disrupted crude shipments in 2003, American refineries were left scrambling. To curb Venezuela's dependence on the U.S., which absorbs

60% of the country's oil exports, Chávez has been working to find new markets. In December he inked deals to sell 120,000 barrels a month of fuel oil to China and to eyeing pipelines that could ferry large amounts of crude to Pacific ports.

For now, Venezuela has little choice but to keep selling most of its oil to the U.S., where refineries are outfitted to handle high-sulfur, heavy Venezuelan crude. If oil-hungry China builds similar refineries, Chávez will have a much freer hand diverting oil from U.S. customers. U.S. Senator Richard G. Lugar (R-Ind.), recently asked the Government Accountability Office to conduct a study to determine how the U.S. might co-



VENEZUELA'S REVERSAL OF FORTUNE



REFINERY
The oil market
in 2003
badly



CARACAS Chávez' social spending keeps him popular

strate for a drop in Venezuelan imports. So far, Chávez' oil-fueled revolution appears to be going according to plan. The millions he spent on the poor helped him at a recall referendum mounted by the opposition last August. It also powered consumer spending, boosting growth to 3% last year—after two years of steep declines. Barring some unforeseen event, Chávez should handily win another six-year term in elections next year.

STARVING GIANT

EVERYTHING depends on PDVSA's health. Interviews with former employees, foreign oil-company execs, and industry analysts indicate that the company has sustained heavy, perhaps long-term, damage under Chávez. The evidence: The government says Venezuela's oil output at 3.2 million barrels per day, but the Organization of Exporting Countries puts it closer to 2.6 million. That's down sharply from a peak of 4 million in 1997. And despite sky-high oil prices, Central Bank data show that the oil sector of the economy actually shrank in the last three quarters of 2004. "The company is only a shadow of what it used to be," says Luis Giusti, PDVSA's chairman from 1994 to 1999, and now a senior energy adviser at the Center for Strategic and International Studies in Washington.

Much of the decline can be traced to the paralyzing strike of two years ago. Angered by Chávez' appointment of a political ally to head a company that long prided itself as a meritocracy, some 18,000 of PDVSA's employees walked out, shutting down exports for two months. Chávez retaliated by firing them all.

It was a crippling blow, even if high oil prices mask the damage: PDVSA's preliminary 2004 results show a \$6.5 billion profit on revenues of \$63 billion. Yet, by other measures, PDVSA is hurting. Production levels at some of the country's most important wells are dropping at a rate of 25% a year, which means the company must ramp up exploration to keep output steady. Yet the number of exploratory rigs is down to 67 as of January, from a high of 119 in 1997, according to Baker Hughes Inc., an oil-services firm based in Houston. Independent analysts say this is evidence that the company is being starved of capital. PDVSA director Eulogio Del Pino insists the company continues to invest \$5 billion to \$6 billion a year in development and exploration: "Our [goal] is to reach production of 4.9 million barrels a day within five years, so we are investing according to that plan."

Venezuela's chances of making that target depend hugely on foreign oil com-

panies, which today account for almost half of total production. The opening of the nation's oil sector to outside capital 10 years ago has netted some \$25 billion in investments, with 22 foreign oil companies now present in the country.

Yet in October, Chávez hiked royalties on major heavy-crude exploration and refining projects in the country's Orinoco belt from 1% to 16.66%, arguing that the hike was justified based on market conditions. "These are highly profitable [projects], even considering the government's decision to [change the royalties]," says PDVSA's Del Pino. With the exception of Exxon Mobil Corp., which protested the increase and says it wants to negotiate a better deal, the oil majors have kept quiet. "We've been in Venezuela for 90 years, and we'll be here another 90 years," says Sean Rooney, Shell Oil Co.'s new president for Venezuela operations.

The terms on new ventures will be even less favorable—30% royalties and a 51% stake for PDVSA. That could dampen enthusiasm for a new round of projects, especially since the new rules will not be finalized until mid-year. "We need a legal framework. Sanctity of contracts is key for us," says Luis Xavier Grisanti, who heads the Venezuelan Hydrocarbons Assn., which represents foreign investors.

The irony is that Venezuela's need for foreign investment in its oil industry will probably only increase. "We already killed the goose that lays the golden egg," says Ramón Espinasa, who stepped down as PDVSA's chief economist when Chávez took office in 1999. "That means the country will have no choice but to open even further to private international capital." Chávez' supporters counter that the old PDVSA was staffed by overpaid executives who cared little about using oil profits to improve the lot of poor Venezuelans. "Now employees are much more conscious of how important the company is for Venezuela," says Del Pino.

Chávez has even more plans for PDVSA. In February he signed agreements with Brazil that call for Petrobrás, the state-run oil company, to help develop Venezuela's production and refining capacity. It's part of Chávez' dream of creating "Petroamerica," a Latin oil-and-gas giant controlled by the region's state-run oil companies. It may be far-fetched—but it's abundant proof that Chávez' aggressive oil diplomacy has just begun. ■

—By Geri Smith in Caracas

BusinessWeek online For a Q&A with PDVSA director Del Pino, please visit us online at www.businessweek.com/extras

GERMANY

RAVENOUS
FOR BAD DEBT

Workout veteran Lone Star is thriving by buying up Germany's troubled loans



MAKEOVER Lone Star bought blocks of apartments from Berlin to fix up

THE LOW-RISE GLASS AND STEEL building in Frankfurt where Lone Star Germany has its offices is partly empty, which is appropriate enough. Germany's troubled real estate market, with high office vacancy rates and stagnant housing prices, has been a disaster for banks such as Munich-based HVB Group or Bankgesellschaft Berlin. But it has been a bonanza for private equity firm Lone Star.

German banks offloaded bad loans with a face value estimated at \$13 billion to \$16 billion last year, and Lone Star was by far the biggest buyer, accounting for as much as two-thirds of the market. In one eye-popping deal last September, Lone Star acquired troubled loans with a face value of \$4.8 billion from Hypo Real Estate Group, a spin-off of HVB Group. While Lone Star does not release financial information, it has made Germany a major focus of operations. And Karsten von Köller, 65, a veteran German banker who postponed retirement to become chairman of Lone Star Germany last year, says the firm is hungry for more deals. "Our

appetite is not yet satiated," he says.

It was Lone Star Funds, based in Dallas, that launched Germany's distressed real estate business. That makes sense. Funds founder John Grayken cut his teeth on deals for bad loans stemming from the U.S. savings and loan crisis before setting up Lone Star in the mid-1990s. The Harvard MBA, considered one of the savviest dons of the private equity business, has expanded Lone Star's range rapidly in the last few years. It now has offices buying up distressed assets of all kinds, but especially real estate, from Dublin to Tokyo. "They're very good at what they do," says David Abrams, a New York-based managing director at Credit Suisse First Boston who has worked with Lone Star in Germany.

But can Lone Star continue to domi-

nate in Germany? That may not be easy as competition intensifies. Annual returns estimated at up to 22% have drawn other players such as Credit Suisse, Goldman Sachs, and German institutions such as Deutsche Bank and Commerzbank. And there are fewer multi-billion-dollar debt portfolios to bid on. Instead, smaller German banks—with smaller portfolios—are making their way to market. What's more, much of the debt being sold is commercial, which is more complicated to value and restructure than real estate. That will make it harder to maintain the returns investors have come to expect, which range from 10% a year for lower-risk portfolios to well above 20% for riskier deals. "Prices right now are good for [the German banks]," says Wolf Waschkuhn, head of the German desk at New York-based consultant Kroll Inc.

HEALTHY AGAIN

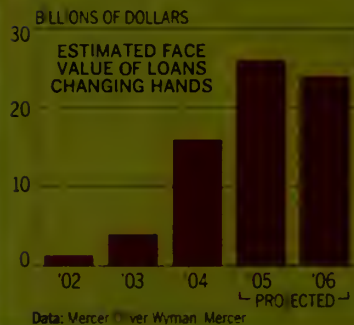
EVEN SO, Lone Star is in a better position to profit than most of its rivals because of the depth of its experience and because of Köller's wide range of contacts in Germany Inc. Under Köller's predecessor Roger Orf, who is now at Citibank, Lone Star effectively invented the German market for distressed debt, with deals such as the 2003 acquisition of the loan portfolio of bankrupt Gontard & Metz Bank. Since then, Lone Star and smaller players such as Los Angeles-based Octree Capital Management LLC have helped German banks clean away at some \$20 billion in bad debt, much of it stemming from ill-advised property investments in Eastern Germany.

While the German banking establishment was hesitant to open the door to foreign funds, few doubt that Lone Star has

done German banks a favor. The influx of capital has made the nation's banks healthy enough to begin lending again. HVB Group averted a debt downgrade after reporting on Feb. 24 better profits and a plan to dispose of its billions in remaining problem loans. "German banks are not exactly the most prosperous in Europe," says Finja Carolin Kütz, a director in the Munich office of New York-based strategy consultant Mercer Oliver Wyman. "It's helpful when the ener-

BAD DEBT DEALS

Purchases of German bank loans have skyrocketed



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ELIMINATING EMISSIONS AND

Someone should make hydrogen vehicles and their refueling stations a reality. Only GM could. Only General Motors has teamed up with Shell to introduce the nation's first hydrogen refueling pump at a retail station. It's the endgame of a multi-faceted strategy GM set in motion years ago to make cleaner cars and trucks powered by hydrogen. Right now, a test fleet of hydrogen-powered GM vehicles

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and time of management is not taken up with old problems.”

Lone Star, for its part, says it's ready to bid on whatever the market offers. One of its biggest deals in Germany was completed in two separate tranches in 2000 and 2002, when it bought whole blocks of half-finished communist-era apartments from the city of Berlin for \$330 million. Lone Star completed and renovated some 5,000 flats, then raised rents. Indeed, the firm seems willing to take on any challenge as long as the price is right. “Banks sometimes ask us what we want to buy,” Köller says. “It doesn't matter. We buy anything.”

One person who has worked with Lone Star and declines to be named praises the methodical way the firm studies the assets underlying the debt it's considering, then works out a business plan. Work-

outs are handled by Hudson Advisors LLC, a sister company that has developed its own analytical software based on its experience in the U.S., Japan, and other markets.

Keeping Köller from retiring also seems to have

been a smart move. Köller had previously been CEO of Eurohypo, a joint venture of Deutsche Bank, Allianz Group and Commerzbank that is Germany's biggest mortgage bank. Köller is also a former president of the Association of German Mortgage Banks. His contacts and reputation helped German banks warm up to the idea of selling their bad loans, rather than trying to do the workouts themselves. The country's dozens of public Landesbanks and savings institutions have become easier to persuade as they face the loss of their state guarantees in July.

By Köller's reckoning, it will take several more years for German banks to bring their troubled loans down to normal levels. Meanwhile new markets for bad debt are developing in Eastern Europe as those banking systems mature. Other European Union countries such as Italy also have big stores of bad loans, distressed debt specialists say. Somewhere there will always be somebody who can't pay—a fact of life that should keep Lone Star Funds busy in Europe for years to come. ■

—By Jack Ewing in Frankfurt

RUSSIA

A RUSSIAN REVOLUTION ... IN THE FASHION BIZ

Ambitious designers are honing their skills, but can they make a splash in global couture?

THE RUSSIANS ARE INVADING. Russian fashion designers, that is. A dozen are planning to make their U.S. debut in May at Miami Fashion Week of the Americas, marking the first time Russian designers have attended a major American fashion event en masse. Several plan to show at New York Fashion Week in September, and move on to Los Angeles a year later.

American fashionistas may be in for a surprise. Russia is no longer the land of shapeless shifts and ill-fitting polyester shirts. The collapse of communism has given free rein to Russians' traditional creativity and love of self-adornment. “Only two countries, Russia and Italy, have a similar mentality. We really love to decorate ourselves,” says Natalia Vinogradova, president of the Russian Association of Fashion Houses.

One hopeful for the U.S. market is Vemina, a design house founded in 1990 that signed Alina Kabaeva, a gold-medal Olympic rhythmic gym-

nast, to model its upmarket clothes in Miami. It is also negotiating with tennis stars Anna Kournikova and Mar Sharapova. In Russia its customers include politicians' wives and film stars. It's targeting showbiz stars in the U.S., too, but also hopes to sell \$500 suits to male professionals. Lisa Romanyuk, Vemina's lead designer, admits that efforts to expand beyond Russia have had little impact. Sales in Western Europe make up “just a small percent” of Vemina's sales. But she has hopes for the U.S., where “the market is bigger.”

LEADING LIGHT
From Vemina's spring show



A small number of Russian designers have already made their mark. Helena Yarmak, one of the few Russian designers to strike a chord in the U.S., says she chose an English-sounding name because Russian names didn't carry the same weight. Clients for her fur coats, which go for \$500 to \$240,000, include Hollywood stars such as Jim Carrey and Goldie Hawn.

Such success is hardly typical. Alexander Shumsky, organizer of Russian Fashion Week, says Russian designers would be better off focusing on the growing domestic market. He gives the example of Max Chernitsov, 27, a rising star who was the first homegrown designer to land a deal with TsUM, a major Russian department store. Too many Russian designers focus on *haute couture* instead of less glamorous but more profitable ready-to-wear lines. Shumsky adds, though, that the Russians are quick learners. “Three years ago most Russian designers thought fashion was art. Today, at least half of them understand that it's a business,” he says. The global rag trade is about to get more interesting. ■

—By Jason Bush in Moscow

One Foot on The Runway

COMPANY/ LEAD DESIGNER	DESCRIPTION
Vemina Lisa Romanyuk	Women's business suits and evening wear
Feeric Ekaterina Kobzon	Elegant and casual dress for women
Beliakovskaya Fashion House Tatiana Beliakovskaya	Fur and winter clothing
Bouton Alisher	Showbiz costumes, sexy summer wear

Data: Russian-American Trade Promotion Council of New Jersey



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DENMARK

THE CRISP, CLEAR SOUND OF RISING PROFITS

High-end audio maker B&O is being rewired, and investors are singing

NO OTHER MAKER OF TVs and stereos has enjoyed the panache of Denmark's Bang & Olufsen. For fashion-conscious Baby Boomers, B&O's sleek and expensive audio-video equipment was once the epitome of cool. But in recent years, B&O has stalled. Its gear seemed like an out-of-tune luxury in the era of the iPod.

Now B&O is getting its groove back. At the MGM Grand in Las Vegas, technicians are busy wiring penthouse hotel suites with B&O sound systems and flat-panel TVs. B&O is also courting yachtmakers, jet-leasing companies, and developers of high-end real estate. And for the first time, the Danish company is taking its show out of the living room and onto the road. On Mar. 1, B&O unveiled a car stereo developed with German auto maker Audi that features a head-pounding 14 speakers, including two cylindrical "acoustic lenses" that rise

silently out of the dashboard when the car starts up. Set to premiere this fall in Audi's \$75,000 A8 model, the high-tech toy is likely to cost thousands of dollars. "It's all a way to get more people to touch our brand," says Chief Executive Torben Ballegaard Sorensen, who took charge at B&O in 2001 following a six-year stint at Danish toymaker LEGO Group.

These partnerships are essential if B&O is to revive its glory days. Founded in 1925 by a pair of young engineers, Peter Bang and Svend Olufsen, B&O made its mark in the '70s with beautifully designed products that appealed to status-conscious buyers. But by the time Sorensen landed in Struer, this icon

WORTH THE PRICE? The \$16,000 BeoLab 5 speakers won raves

of Danish business risked slipping into irrelevance. Plagued by inefficiencies and complacent management, B&O was turning in lousy numbers. Worse, it had lost its technical edge. Its super-expensive gear, ranging from \$2,000 boom boxes up to \$50,000 home-theater systems, looked gorgeous, but audiophiles turned up their noses at the sound quality. "There was a gap between our image and our performance," says Sorensen. "We called it the 'pretty-face syndrome'."

'A FRESH WAY OF THINKING'

SORENSEN GOT TO work fast. He parceled staff from 3000 to 2200 and closed dozens of struggling B&O stores. He also moved to fix B&O's image by rolling out high-performance products like the BeoLab 5 series. The \$16,000 speakers, which debuted in 2003 to rave reviews, incorporate a technical breakthrough called the acoustic lens. Just as camera lenses focus light, acoustic lenses reshape sound, spreading it horizontally to increase the sensation of space. "Sorensen has added a fresh way of thinking at B&O," says Niels Letten, an analyst at Swedish investment bank Enskilda.

That has investors tuning back in. B&O's shares are up 23% over the past months, double the rise in Copenhagen stock index. Brokerage Alfred Berg, a subsidiary of ABN Amro, forecasts net profits of \$46 million for the fiscal year ending in May, on the back of 3.5% growth in revenues, to \$665 million—the first such increase since 2002. Next year, revenues should climb 6.8%.

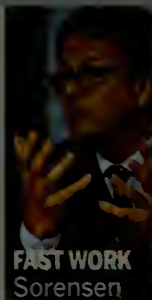
To maintain momentum, Sorensen is pushing B&O's engineers to venture farther afield. The company has just introduced its first hard-drive-based personal video recorder, the \$1,600 HDR 1, and is working on a product that will let customers download music from the Web without a PC.

In a first for the company, Sorensen is also contemplating moving some production out of Denmark. A plan to shift 200 jobs to a new plant in the Czech Republic by 2006 could save B&O \$7 million a year. That could be real music to shareholders' ears. ■

—By Andy Reinhardt in Struer, Denmark

Putting More **Bang** in B&O

The Danish company has a plan to pump up the volume on sales



FAST WORK Sorensen

NEW BUSINESSES Rolling out its first-ever car stereo in September with Audi and cutting deals with hoteliers such as MGM and Hyatt to put its audio-video gear in high-end suites

MORE STORES Opening new stores in choicer spots, including 10 in fast-growing China

BOOSTING PERFORMANCE Introducing new technologies that raise performance to match aesthetics and sky-high prices

Data: Company reports, BusinessWeek



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EDITED BY ROSE BRADY

Hong Kong: Why Hu May Topple Tung

TUNG CHEE-HWA on the way out? Hong Kong's rumor mill began turning after an announcement in early March that the city's Beijing-appointed boss had been named to the largely ceremonial Chinese People's Political Consultative Conference in Beijing. As Tung headed to a meeting of that advisory body, reports were

facing in local newspapers that he may have resigned his Hong Kong post. The 67-year-old former businessman's reaction? "I will give an account of the matter at an appropriate time," he said stonily. If Tung leaves, as seems likely, his ouster will say as much about Chinese President Hu Jintao as about his own beleaguered tenure as Hong Kong's boss. Tung's departure would be the latest sign that Hu, who took office two years ago, is implementing a new strategy to deal with China's troubled relations with the rest of the Greater China triangle: Hong Kong and Taiwan. Like his predecessor, Jiang Zemin, Hu takes a hard line on core issues, ruling out democratic reforms in Hong Kong and threatening Taiwanese who advocate national independence. This is an occasion to reiterate the message that the new leadership in Beijing is firmly in power, says Christine Loh, director of Civic Exchange, a Hong Kong think tank. Hu has been trying to soften the blows with policies to appeal to the masses.

More Accountable

GETTING RID OF Tung would win Beijing points among Hong Kong people tired of his indecisive leadership. Even critics of the government concede it will improve without Tung. Donald Tsang, Tung's No. 2 and most likely replacement, "has more credibility," says Albert Cheng, a pro-democracy member of the legislature. "There will be a more accountable government with stronger leadership." But Tung's departure also helps Hu deal with the longer-term issue of direct elec-

tions in Hong Kong. Tung's term was supposed to last until 2007, and the debate over how to choose his successor has been fierce. By forcing Tung out now, Hu can ensure that a pro-Beijing committee of just 800 appointees chooses his replacement, who will serve a new five-year term until 2010. That will give Hu three years to push off calls for democracy and to maintain control over Hong Kong's leaders.

If Hu can keep protesters off Hong Kong's streets, he will also strengthen his hand in dealing with Taiwan. Anti-Beijing demonstrations in Hong Kong could play into the hands of Taiwan's independence advocates, who badly need a boost. Since President



NEW BROOM? Tsang (left) could take over from Tung

Chen Shui-bian's pro-independence alliance failed to win control of Taiwan's legislature in December, he has been making conciliatory gestures toward China. For his part, Hu is wielding both a stick and a carrot. The National People's Congress, China's rubber-stamp legislature, is set to pass a new anti-secession law that some fear China could use to justify military action against Taiwan. But Hu has also opened China's markets to Taiwanese agricultural products. That move could earn Beijing points among Taiwan's farmers and weaken their support for independence.

Hu's strategy seems to be working, but it won't be smooth sailing. Even if Beijing pleases Hong Kongers by ousting Tung, there's no sign the pro-democracy camp will give up its universal suffrage demand. And cross-strait relations remain tense. It will take a lot more for Hu to win hearts and minds in China's restless periphery. ■

—By Bruce Einhorn and Frederik Balfour in Hong Kong

GLOBAL WRAPUP

INDONESIA'S PRESIDENT PULLS OFF A KEY REFORM

ON FEB. 28, THE CALCULATED gamble of Indonesian President **Soesilo Bambang Yudhoyono** to cut fuel subsidies won applause from the financial markets and, apparently, grudging acceptance from the public. The reform, which raised prices for gasoline, diesel, and other fuels by 30%, sparked a 1.8% jump on the Jakarta stock market.

Street protests against the move broke out in several cities but quickly fizzled out—a big change from 1998 and 2003, when thousands protested efforts at fuel price reform. Yudhoyono's deft handling of the fuel issue will strengthen his hand as he tries to implement an ambitious agenda to boost infrastructure spending and lift economic growth from last year's 5% to 7% by 2007.

HAVE THE TORIES FOUND A TRUMP CARD?

WITH THE British general election expected in May, the Conservative Party is turning immigration into a key campaign issue. And it seems to be paying off. Conservative Party leader **Michael Howard** has pledged to introduce an annual ceiling on immigration, a quota for asylum seekers, and a points system to reform the country's "chaotic and out-of-control" work-permit system. **Tony Blair's** Labour Party has also proposed a points system but no quotas. A recent poll by research firm MORI showed that 40% of British voters name immigration and asylum as top issues—ahead of health care and education. In the best showing for the Tories in 18 months, some 37% of people said they planned to vote Tory vs. 39% for Labour. While Blair's party is still favored, the Tories' stance on immigration could make the race tighter.

Hot Audi

It's finally a contender in the luxury-car race. Can it catch BMW and Mercedes?

CHEF SACHE. THAT'S German for "the boss's business." And when it's the boss's business at Audi, watch out. Each month, Audi's compulsive chief executive, Martin Winterkorn, rolls up his sleeves and leads a trouble-shooting session with engineers at the company's electronics center, zeroing in on faulty systems and problem parts. Winterkorn's rules: no shifting the blame to anyone else, such as suppliers. No phone calls to subordinates—the brains to remedy the defects better be in the room. And no one leaves until a fix is found.

The boss's business extends way beyond that monthly session. Not even the smallest buttons on the dashboard escape Winterkorn's attention. At the first auto show under his watch, he summarily ordered a gorgeous Audi sedan removed just hours before the opening: The stitching on the upholstery wasn't right. (Audi staffers now bring two of each model to every show.) The 57-year-old PhD in metal physics is obsessed with creating perfect cars. "We want to be the

No. 1 premium brand," says Winterkorn.

There's a lot riding on his precision mania. Audi, the \$32 billion high-end car unit of Volkswagen, has been striving for two decades to move its cars upmarket. The effort has cost billions in investments in technology, design, and performance. The goal: to match the exclusive image of mighty Mercedes-Benz and BMW. Individual Audi models have been making a splash for years. The 1994 aluminum frame A8 sedan was an industry first. The iconic Audi TT sports roadster and coupe, introduced in 1998, polished Audi's image as a design leader. The A4's cool, minimalist styling and powerful four-cylinder motor created a new generation of popular Audis, including the sizzling Cabriolet. The A4 line accounts for nearly half of all Audi sales.

Now, Winterkorn is presiding over the arrival of Audi into the front ranks. On Feb. 16, Detroit-based *AutoWeek* voted the \$41,000 A6 sedan its Car of the Year. Late last year the magazine heralded Audi's flagship luxury model, the A8, as America's best luxury car. In car-crazed Germany, *Auto Motor & Sport* on Feb. 15 elevated Audi to No. 1 in its four key model

CABRIOLET The A4 line accounts for 50% of sales



segments, from the A3 compact to its flagship A8 sedan. "Audi is on the cusp of a full first turn as an international luxury brand," says James N. Hall, vice-president for industry analysis at researcher A.P. Pacific Inc. in Southfield, Mich.

AVANT-GARDE STYLING

AUDI IS BUILDING UP a roster of famous customers, from Spain's King Juan Carlos to musician k.d. lang. It's also luring buyers from rival German auto makers. Bernd Pooch, chief executive of a Berlin machine-tool maker, was a diehard BMW fan. But last November, turned off by the avant-garde styling of the latest 7 Series, the 64-year-old test-drove a \$100,000, 275-horsepower Audi Quattro A8. Smitten by the smooth handling and finely crafted interior, he quickly signed a lease. "People just don't know how good Audi really is," he says.

That's especially true in the U.S., where Audi sells less than half the volume of BMW, Mercedes, or Toyota Motor Corp.'s luxury brand Lexus (page 6). Audi suffers in the U.S. from an outdated sales and marketing network and a reputation



KUDOS FOR THE A6
AutoWeek voted it
Car of the Year

gy electronic systems. Reliability "has our Achilles' heel," admits Marc Man, Audi of America's quality director. To ratchet up its global standing, Audi is smooth out its U.S. kinks. till, the numbers track Audi's upward ch. Revenue per vehicle is \$41,389, up \$25,125 in 1994. Sales have nearly ed, to more than \$32 billion in the e period. Profits in 2004 rose 7.4%, to a record \$1.15 billion. The share price small tranche of Audi shares still trade, (VW's ownership) has soared to 7 from \$79 in 2000. In Europe, Audi ly matched BMW's sales last year, 559,428 vehicles to BMW's 579,632. most powerful versions of A8 outsell Mercedes and W models with comparable ines. "In the last 15 years, i has made an incredible ance," says BMW CEO Hel-Panke. "They wanted to be accepted as a premium d, and they made it." Audi, though, is just finish- the first lap of a long race. It must strengthen global s outside Europe and add models to match the depth BMW and Mercedes offer- . Audi also has a long way

to go to match the revenue and profit horsepower of Mercedes and BMW. Last year, Audi clocked sales of 779,000 cars, but Mercedes and BMW sold more than 1.2 million each. By revenues, Audi is still only 55% the size of BMW and 48% that of Mercedes-Benz. Audi's profits are a fraction of its rivals' income, too, since it has fewer expensive models on the market. To remedy that, Winterkorn aims to spend some \$15 billion over the next four years, 80% of it on new products.

The son of Hungarian emigrants who moved to Germany in 1945, Winterkorn admits his weakness is impatience. To get workers charged up, he exhorts his

troops to take risks and own up to failure quickly. "What he hates is when people cover up mistakes or problems, or shift the blame to someone else," says one manager. The trim and demanding "big boss," as Audi workers refer to Winterkorn, prowls the production line and software labs seeking intelligence from line workers and technicians. A favorite Winterkorn saying: "Don't bore me with the good news. Give me the worst."

In Winterkorn's race to bulk up Audi's size, 2005 is a crucial year. The new models launched in 2004 in Europe have given Audi momentum. It has one of the newest fleets on the market, including the elegant new A6 sedan, redesigned A4 sedan, and the A3 hatchback. A keenly awaited product is the Q7 SUV, costing roughly \$40,000, which will hit European showrooms in early 2006, followed by a baby SUV, the Q5, one year later. Under wraps is a sports car in the \$100,000 to \$200,000 range, dubbed the Le Mans, which is expected to have a 610 hp engine that can accelerate from 0 to 60 mph in just 3.7 seconds. "It would show that anything BMW and Mercedes can do, Audi can do better," says Garel Rhys, professor of automotive economics at Cardiff Business School in Wales.

But the Audi chief's biggest priority for 2005 is clinching quality gains. Winterkorn is betting his three-year crusade to stamp out glitches, especially in electronics, will boost Audi's rankings above its German rivals in J.D. Power & Associates Inc.'s 2005 quality and reliability rankings, due out in June. "If they make sure they get quality right, they could pick up a lot of dropped straws," says Auto-Pacific's Hall.

MOVING UP IN THE RANKINGS

LIKE ITS GERMAN RIVALS, Audi's cars have been plagued since the late 1990s with electronic snafus as auto makers stuffed more and more microchips into their vehicles. But years of hard work are starting to pay off. In J.D. Power's 2004 ranking of initial quality, Audi moved up three places to rank 11th out of 37 auto brands, one place above BMW and one notch below Mercedes. Chance Parker, Power's quality guru, says Audi still needs to improve its reliability over the long haul—an area where Winterkorn hopes Audi will excel this year. "Some of Audi's [last-generation] launches have been very buggy," Parker says. That's why

AUDI'S UPMARKET DRIVE



The Corporation Autos

(Q.Q.Q.)

**BEIJING A8
LAUNCH** A big
lead in China

Audi is 22nd in Power's 2004 ranking of long-term dependability. The good news for Audi is that Mercedes sank to 28th. Audi's ratings should trend upward thanks to the quality of the new models hitting the market.

Audi's other tough goal will be boosting visibility in the U.S. Of Audi's 263 dealerships, 127 share floor space with other brands, and 115 also sell Volkswagen. Johan de Nysschen, Audi of America's boss, is in the middle of a major push to upgrade dealerships. "The cornerstone for brand building is making Audi more successful in the U.S.," says Albrecht Denninghof, senior auto analyst at Hypo-und Vereinsbank in Munich.

Winterkorn, who took control in March, 2002, is just starting to put his stamp on the company. He started at Audi in 1981, moved in 1993 to VW as chief of quality, and then became head of product development. He is close to VW Chairman and former Audi boss Ferdinand Piëch, the architect of Audi's upmarket strategy. Ironically, it was Winterkorn, at Piëch's bidding, who developed VW's ill-fated luxury sedan, the Phaeton. A rival to the A8, it flopped in the market despite strong praise for its engineering.

Now, Audi's growth and profits are increasingly vital to Volkswagen, where high costs and missteps with key models have clouded prospects. Although internal tussles with VW over shared platforms and competing model launches have cost Audi precious time in getting cars to market, the division accounted for nearly 100% of VW Group's net earnings last year. In 2004 the average operating profit per car at Audi was \$1,374, while Volkswagen brand cars, suffering

from high costs, model mistakes, and an aging fleet, lost an average \$13 per vehicle, according to Paris brokerage Exane.

The wholesale parts-sharing of the early 1990s between Audi and VW has given way to a more sophisticated sharing of modules that still saves money but allows Audi cars to look and behave differently. And VW's plummeting profits have dashed Piëch's ill-fated drive to push Volkswagen upmarket. A recent report by Morgan Stanley puts Audi's value at \$14 billion—80% of VW Group.

Winterkorn is reaping the payoff of billions of dollars in investments since 1980 when Audi kicked off its upmarket bid with the "Quattro" four-wheel-drive system. To earn its stripes, Audi had to out-engineer its rivals, setting industry benchmarks in everything from lightweight aluminum frames, drive systems,

and engine performance to the "skin" materials covering plastic parts give Audi's interiors a richer feel. The auto maker's navigation and information system wins high marks as user-friendly and intuitive. "Audi is like the iPod of cars. It's more intelligently designed," says Bill Joy, partner at venture-capital firm Kleiner Perkins Caufield & Byrd in Menlo Park, Calif., and former chief scientist at Sun Microsystems Inc.

Audi's 53,000 workers—proud of the company's engineering heritage, which goes back to founder August Horch—are as obsessed as Volkswagen with building cars that outpace BMW and Mercedes. Production Chief Frank Dreves pauses in the lobby of Audi's headquarters to make a point about the latest A3 Sportback. "Feel this," Dreves, running his fingers over a

new invisible laser-welded seam between the roof of a tomato red car and the rear window panel. "This is normal for a car in every car. We've invented a new laser welding process to eliminate the rear window gutter to reduce interior noise. None of our competitors bothers to do this."

Forging a luxury brand has also required stand-out design. In 2002, Piëch hired Italian designer Walter

Maria de Silva to Audi from Alfa Romeo. A year later, De Silva unveiled a more sculptured look for the A6 and A8 sedans that started hitting the market last year. The deep front grille, now being extended through most of the model range, gives Audi an edgier look.

But closing the revenue gap with BMW and Mercedes will take another generation of cars at least. Audi has six luxury models, compared with 10 at BMW—to be 12—and 13 at Mercedes. By selling more top-end cars, BMW and Mercedes

generate much greater revenues and higher margins. In 2004, Audi earned an operating margin of 5.5%. "Our goal is to achieve an operating profit margin of 8% within this decade," says Audi Chief Financial Officer Rupert Stadler.

One risk along the way is that a struggling company shaves capital expenditures, crimping Audi's investments. Winterkorn in his \$15 billion investment plan is secure, but

**Audi still
sells far
fewer cars
and makes
less money
than rivals**



WINTERKORN He's
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The Corporation Autos

Chief Executive Bernd Pischetsrieder has announced he aims to cut spending 6%, or nearly \$1 billion, over the next two years.

Audi also needs to invest heavily in marketing and distribution outside Europe to match BMW's and Mercedes' global reach. Although Audi is already a premium-car market leader in China, with a 65% share, rivals are coming on strong, and the market for luxury vehi-

cles has slowed. In Japan, where Audi trails BMW and Mercedes, Winterkorn has canceled a dealership-sharing agreement with Toyota and set up a network of 100 exclusive dealerships. He's also planning to spend \$130 million on building a dealer network in Russia over the next five years.

For Winterkorn, the final heat to catch BMW and Mercedes is the challenge of a lifetime. For Piëch, likewise, a victory

would crown his life's work as engineer and manager. But getting there will require perfect execution—and a steady hand on the wheel. ■

—By Gail Edmondson in Ingolstadt, Germany, with Kathleen Kerwin in Detroit and Karen Nickel in Anhalt in Bo-

BusinessWeek online For a slide show of Audi's newest models and a history of the company, go to www.businessweek.com/extra

THE U.S. MARKET

Still a Long Way To Go In America

It would be hard to find a more devoted Audi fan than Mark Fullerton. The CEO of a Cincinnati tech-services company and his wife have owned 27 Audis. Fullerton, 53, has toured Audi's factory in Ingolstadt, Germany, six times, and attended its driving school four times. "I believed no one could seduce us away from Audi," he says. So why has Fullerton recently been test-driving cars made by Japanese and other German auto makers?

He fears Audi has lost its edge. Not long ago, he says, "Audi was the only game in town" if you wanted a premium performance car with all-wheel drive at lower prices than its rivals. Now nearly every luxury carmaker offers AWD. And thanks to generous lease terms, Fullerton can lease a \$57,620 BMW for \$736 a month, about \$100 a month less than what he'd pay on a comparable \$54,770 Audi. "It pains me," he says.

It pains Audi dealers, too, since leasing accounts for 43% of their sales. Last year, Audi's U.S. sales fell 10%—their first decline in a decade. Management shake-ups rattled dealers. And even as the new A6 sedan was drawing rave reviews, sales got off to a slow start, with little promotion when it hit showrooms last fall. "The good news is that the A8, A6, and new A4 have exceptionally good quality, but in the short term, we're not playing with the full quiver of arrows that the other guys have," says Bill Hoehn, owner of a Carlsbad, Calif., Audi dealership.

Despite a decade on the comeback trail, Audi is still running behind archrivals BMW and Mercedes-Benz in the minds of American consumers. The carmaker is hampered by a weak dollar, a shaky U.S. dealer network, and a narrow lineup that

includes no sport-utility vehicles. And it still needs to improve its long-term reliability.

That doesn't mean Audi isn't on the upswing. Its U.S. sales jumped 16% in February. Its American executives and engineers are working closely with their German counterparts to eliminate glitches.

Audi Needs an SUV

Its rivals depend on them for a big percentage of U.S. sales

*U.S. sales in 2004
Data: Ward's Auto Info-Bank

SUV sales as percentage of total*

PORSCHE
58%

LEXUS
53%

BMW
24%

MERCEDES
12%

AUDI
0%



LONG-AWAITED The Q7 will debut in spring 2006

They're convinced Audi will crack the Top 10 when the latest J.D. Power & Associates' Initial Quality Study is issued this spring. And they are counting on those new models. Says Johan de Nysschen, Audi of America chief: "We will have the newest product lineup in the luxury sector." But de Nysschen is also dead set against raising incentives—and that includes more generous lease deals. Piling on big incentives effectively lowers a car's pricing, which would hurt both Audi's image and the resale value of its cars. Says de Nysschen: "I don't want to undo all the good that has been done."

The problem is the new model that Audi

quality reputation. Audi "has to overcompensate," says Marc Trahan, the company's U.S. quality director. Still, he had to work to convince the Germans to listen to American consumers and move cup holders from the instrument panel, where coffee sloshed onto the stereo controls, to the center console. De Nysschen hopes the efforts will turn customers into goodwill "ambassadors" for the brand. That's essential if Audi doesn't want to lose loyalists like Fullerton.

—By Kathleen Kerwin in Detroit, with Gail Edmondson in Ingolstadt

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How to Fix the TORT SYSTEM

A real solution requires pragmatism, not politics. *BusinessWeek's* four-point plan would preserve the benefits and eliminate the excesses. **BY MIKE FRANCE**

Crack? Injury?

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DALLAS PITCH If
only lawyers were
as aggressive at
notifying winners
of class-action
settlements

THIS SHOULD BE A TRIUMPHANT moment for Thomas A. Gottschalk. As the executive vice-president for law and public policy at General Motors Corp., he has devoted his long career to battling plaintiffs' lawyers. So you might think Gottschalk would be thrilled about the recently passed Class Action Fairness Act (CAFA), the biggest federal tort reform of his 62-year lifetime. Guess

again. "CAFA will not eliminate many class actions," predicts the steely former litigator. "It was a modest procedural step."

That's the verdict of most of Gottschalk's longtime allies—from the generals to the ground troops—in America's tort war. They portray the U.S. legal system as a dire economic threat that jacks up the price of cars, drives obstetricians out of work, and effectively taxes all Americans' standard of living. Truly tackling these problems, many business leaders believe, requires a whole lot more than CAFA—or anything else on Washington's agenda. In fact, they find inspiration overseas. Gottschalk, for example, wants to borrow an idea from Britain, where the losers of lawsuits pay for the winners' expenses. Other self-described tort reformers want to reduce the role of juries, whack big damage awards, and truly reshape American justice. "The whole tort reform debate in this country is pathetic," grouses Philip K. Howard, founder of the New York legal policy group Common Good.

That's about the only point that all sides agree on. Plaintiffs' lawyers, union leaders, and consumer advocates accuse Howard, Gottschalk & Co. of polluting the policy dialogue with bogus numbers and misleading anecdotes. They offer a radically different view of reality. Citing Vioxx, Enron, Firestone, WorldCom, and other recent scandals, the business community's opponents

argue with equal passion that now is no time to be loosening restraints on executive misbehavior by eviscerating the role of courts. "Corporate America wants immunity from misdeeds through tort reform," charges Frederick M. Baron, ex-President of the Association of Trial Lawyers of America (ATLA).

Is either side right? How bad is the American legal system? What's the best way to fix it? These issues, for the first time in years, are squarely on the table. Now that CAFA is on the books, Bush wants to move on to medical malpractice litigation, asbestos mess, and beyond. The stakes transcend the narrow, sounding issue of tort law—the body of precedents governing personal injuries. The mislabeled "tort reform" debate touches on antitrust, consumer protection, employment, environmental, and securities law. These all play a key role in determining the safety guidelines for cars, doctors, drugs, food, and construction sites. The cost-benefit choices we make in this arena influence the design of children's toys, the content of 10-Ks, how often office workers must view sexual harassment prevention videos, the amount of money given to asbestos victims, and countless other unique features of U.S. society.

Tort reform, then, is more than simply an economic policy debate. It's also about justice—the ultimate values issue. How people feel about the subject directly depends on how they view things like individual responsibility and the public obligations of private companies. Do they attach more blame to McDonald's Corp. for making fattening hamburgers—or to obese teenagers for eating them? "The debate is really about what kind of culture we want to have in America," says Cornell University law professor Douglas A. Kyser. "A lot of deep political issues get discussed through tort law language."

Problem is, much of the discussion has been distorted by hyperbole from both sides. Despite the alarmism from Corporate America, most of the big verdicts that become urban legends are reduced on appeal. Nor is there authoritative

THE STORY OF AN IMPASSE

How we got into the current mess is a tortuous tale, one that has played out in thousands of courtrooms, legislatures, and law schools. Here are the turning points:

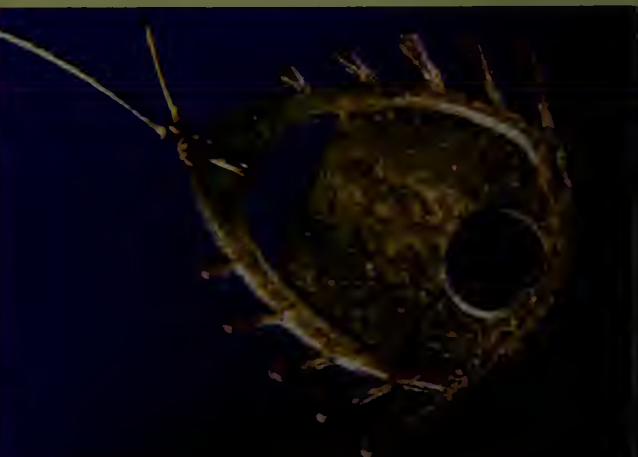
THE PITILESS ERA (1900-45)

A century ago, courts treated disasters as vicissitudes of life and downplayed the role of corporate malfeasance. A stark example: the 1911 Triangle Shirtwaist Factory fire, in which 145 died in lower Manhattan (below). Although there was clear negligence—the escape doors were locked—families of the deceased received payments of only \$75 apiece.



THE LIABILITY EXPLOSION (1945-80)

Corporate liability expanded gradually in the early decades of the 20th century—and then dramatically after World War II. By the end of the 1970s, massive waves of class actions were hitting Corporate America for damages from such dangers as asbestos, Agent Orange, and the Dalkon Shield (below).





ING UP Doctors
y in Chicago to
for tort reform

dence that plaintiffs' lawyers are weighing down the economy. This is, in part, because there are no reliable aggregate data about the system (page 77). America's network of federal, state, and local tribunals is sprawling and undigitized. Nobody knows how many cases are filed each year or how they turn out—especially since the vast majority are settled out of court. So any macroeconomic conclusions are speculative. When Bush claims that the annual "litigation" in America is \$246 billion, it's a guess.

To the extent that reliable data do exist, they show no signs of a bad systemic breakdown. The latest statistics from the Bureau of Economic Analysis indicate that legal services account-

The debate isn't simply about economic policy. It's about **JUSTICE**, individual responsibility, and business' public obligations

ed for less than 1.5% of gross domestic product in 2003—a slightly lower share than in 1990. That means the legal industry has lagged the overall economy. Such slow growth suggests that lawyers are not reaping a bonanza from winning—and defending—big corporate cases. Moreover, the strong productivity gains in recent years undercut the argument that rapacious plaintiff lawyers are strangling growth.

Does this mean there's no case against the tort system? Not at all. Just that the strongest evidence of plaintiffs' lawyer misconduct doesn't rest on broad economic data. Rather, the real crisis lies in the proliferation of specific types of bogus cases—ones in which nobody has been injured, no malfeasance has occurred, or regulators have already taken care of the problem. Despite their claims of being selfless safety advocates, plaintiffs' attorneys in 2005 are analogous to chief executives in 1999: Most of the players are making an honest living. But an unacceptably high percentage of them are stretching the rules.

BusinessWeek's four-part solution to the problem is based on a set of pragmatic principles, with some parallels to those being used to clean up Corporate America. Like CEOs, lawyers should, first of all, be paid for performance. They shouldn't be allowed to take home multimillion-dollar paychecks if clients get pennies. Second, they shouldn't be able to cash in when they're merely piling on to government crackdowns. Third: When attorneys break the rules, the punishment should sting. These days, lawyers who file frivolous suits barely get their wrists slapped. These simple reforms would eliminate the most abusive cases while preserving the rights of victims. In the rare cases where they did not go far enough, such as asbestos, a far more radical change—exiting the courts altogether—may work better.

Surprisingly, the excesses in America's legal system grew out of the country's commitment to free markets and individual-

BACKLASH (1981-2005)

As plaintiffs' lawyers gained power, efforts to rein them in began. A series of insurance crises prompted state legislatures in Florida, Minnesota, and elsewhere to pass tort reforms. The federal government joined in with the Securities Litigation Reform Act, targeting securities attorneys such as William Lerach (below), in 1995.



TODAY

Despite more than two decades of stabs at tort reform, the plaintiffs' bar is better financed than ever. It now is reaping the rich harvest of Enron and other corporate scandals. Responding to the call of insurers, car manufacturers, and tobacco companies for more help, Bush signed the Class Action Fairness Act on Feb. 18.



ism. Modern tort law began with the unprecedented wave of injuries spawned by the Industrial Revolution. A century ago, when a worker lost his arm in a mill or a consumer got poisoned by canned food, he was generally out of luck, as were his dependents. Few people bought insurance back then, and the courts frowned on personal injury suits. The families of the young women who perished in New York's Triangle Shirtwaist Factory Building fire in 1911, to take one classic case, collected wrongful death payments of just \$75 apiece—despite rotten fire hoses, locked escape doors, and other signs of clear negligence.

Starting in the early decades of the 20th century, in piecemeal fashion, U.S. legislators and judges began tearing down the barriers that protected companies against lawsuits. Until 1916, for example, consumers could only sue the distributors that sold defective products, not the manufacturers. That changed when the wooden wheel on Donald C. MacPherson's 1910 Buick Runabout collapsed. In a landmark opinion, New York state court judge Benjamin Cardozo held that Buick Motor Co. owed a duty to the end user—triggering the first of

Lawyers have to do a better job of **COMPENSATING VICTIMS** as well as deterring corporate wrongdoing

many big bangs in corporate liability. The progressives and New Dealers who championed the expansion of tort liability “wanted to create social insurance for the many misfortunes of life, including accidental injury, disability, and unemployment,” says Robert W. Gordon, a professor at Yale Law School.

After World War II, tort law received a boost from economists—something that would probably come as a surprise to many businesspeople today. A new generation of scholars such as Guido Calabresi and Richard A. Posner (both now federal judges) started writing law review articles packed with dense equations. They argued that the tort system should be more than simply a method of compensating the victims of misfortune. Instead, it should be a free-market tool for preventing accidents in the first place. In the real world, this usually meant hiking the liability on manufacturers, giving them a financial incentive to improve the safety of their products. The economic theory essentially held that the most socially efficient outcome would be achieved when the cost of the safety improvements matched the cost of being sued.

The result is one of those exceptional American institutions that sometimes causes the rest of the industrialized world to rub

its eyes in wonder: A tort system that functions as both an insurance mechanism and as a form of decentralized regulation. Loud-mouthed, Lear-jetting, billboard-advertising plaintiffs' attorneys have been officially deputized to serve as private-sector adjuncts to the Securities & Exchange Commission (SEC), the Food & Drug Administration (FDA), the National Highway Traffic Safety Administration (NHTSA), and a wealth of other federal and state agencies. “Europeans would be extremely nervous with this kind of arrangement,” observes Michael Greve, a German-born tort reform expert at the conservative American Enterprise Institute in Washington.

What do they do in Germany, Belgium, or France when sport-utility vehicles roll over? For starters, the victim's medical expenses are covered by nationalized health care. And lost wages are largely picked up by employers or the government. So nobody needs to go to court to be made whole—and punitive damages aren't allowed. It's basically a no-fault system that renders plaintiffs' lawyers irrelevant, eliminating most of the expensive features of the U.S. adversarial system, such as pre-trial discovery.

That probably sounds great to many in Corporate America. But built into the Western European system is an even greater degree of regulation. Instead of offloading responsibilities plaintiffs' lawyers, bureaucrats and administrative judges do the work. “You can substitute for tort law by having more extensive social insurance and relying on regulators to a great extent,” says Mark Geistfeld, an expert in comparative jurisprudence at New York University School of Law. “But it's like the cost disappears; it just becomes part of the tax base.”

That's why comparisons between the U.S. and other countries are misleading. Britain, Germany, and Japan all have fewer lawyers per capita than America—a fact critics of the U.S. love to cite. But these countries don't ask their attorneys to gage in business regulation, and they have more restrictions on individual rights. As a result, tort changes that call importing a big idea from overseas miss the larger context. Making courtroom losers pay their opponents' legal expenses only works in Britain because it is part of a larger whole that also includes nationalized health insurance.

Throwing out big chunks of the U.S. system, therefore, isn't a grand solution. Sure, it's theoretically possible to eliminate punitive damages or adopt other European-style reforms without bringing aboard their entire social safety net. But it almost certainly wouldn't end there. One way or another, the American

A FOUR-STEP PLAN FOR LITIGATION REFORM

There's no need to toss out the whole system. Instead, rules need to be changed to cut down on bogus cases, ones in which nobody has been injured, no malfeasance has occurred, or regulators have already taken care of the problem.

More on Tort Reform, Only at Businessweek.com

Taking the Cure: Our own four-step plan for improving the legal system in an easy-to-use slide show.

A conversation with Richard E. Anderson of medical malpractice insurer The Doctors Co., who sees the push to litigate as a “parasitic form of venture capitalism.”

The View from the States: While Congress grapples with federal reform, states are taking matters into their own hands.

The History of Tort Reform: An exclusive online slide show.

Poll: Which proposal do you think would make the most difference?

BusinessWeek online

<http://www.businessweek.com/go/tortreform>



PAY FOR PERFORMANCE

Plaintiffs' lawyers sometimes earn millions while clients get pennies. Attorneys should get paid only to the extent that their clients do.



PUNISHMENT THAT STINGS

Lawyers who file frivolous suits usually get wrist slaps. Judges need to make them pay fines or some of the other side's expenses.



CURB THE DUPLICATION

When regulators bust companies for wrongdoing, plaintiffs' lawyers often get easy money by filing redundant lawsuits. That needs to end.



EXITING THE TORT SYSTEM

When all else fails, problems can be kicked from the courts into specialized tribunals with less cumbersome procedural rules.

would hurt the most severely injured malpractice victims, such as those blinded or paralyzed. That would also shortchange blue-collar workers, the elderly, and others who couldn't receive big compensation for lost earnings.

This is the wrong approach. The big mistake of the last century was not excessive compassion. The fact that America offers the most compensation worldwide for intangible emotional injuries is a tribute to the country's best humanitarian impulses. In retrospect, the thing that the legal theorists overlooked was that tort law would become a big business. Invited to become private corporate cops, way too many plaintiffs' attorneys crashed the party. The challenge now is to weed out the parasites without compromising fundamental values. Here's how:

1. Pay for Performance

THIS FIX would eliminate a big chunk of the most abusive cases. The main target would be cases like a 1996 false advertising suit

in which the public will demand that the Firestones and Enrons of the world be held accountable for tire blow-outs and financial blowups. Gradual reductions in corporate liability would undercut the accountability of genuinely bad actors. It wouldn't take long before the public would cry out for more regulation. This is one reason why the AEI's Greve thinks it could be foolhardy for medical-device makers to lobby for broad legal immunity for products approved by the FDA. "As soon as the agency made a mistake and people died, there would be hysteria, and the whole approval process would be shut down," he predicts. "You need a sensible mix of public and private enforcement."

The right way to reform the U.S. tort system is not to put more plaintiffs' lawyers on the streets but to ensure that they do a better job at their two key roles: compensating victims and punishing corporate wrongdoing. The crisis is not that ambulance chasers are wrecking the economy, but that too many entrepreneurial personal-injury attorneys have found illegitimate ways to earn money. Tort reformers aren't directly attacking this problem. Instead of cracking down on exploitative lawyers, the courts often try to solve the problem by punishing their clients. For instance, the White House's main idea for reducing the cost of medical malpractice litigation is to place an arbitrary \$500,000 ceiling on pain-and-suffering recoveries, which

was used against Intel Corp., which awarded 500,000 people the right to claim a \$50 discount off a new microprocessor. Only 150, or 0.0003%, took advantage of the offer. The plaintiffs' lawyers, meanwhile, walked off with nearly \$1.5 million. Hundreds of similar tales could be told. The Intel case highlights the single most scandalous thing about the American tort system: the low percentage of people who truly benefit from class actions. The problem is not confined to the notorious episodes, like Intel, in which people are awarded coupons. Many alleged "victims" don't even bother to collect hard cash. A still unpublished study by James D. Cox and Randall S. Thomas, professors from Duke University and Vanderbilt University law schools, indicates that even sophisticated institutional investors claim less than 30% of the money they could get from securities-fraud class actions.

It's no mystery why this happens. Defendants want to keep redemption rates low—and many plaintiffs' lawyers don't care. Their fees are set when deals are signed and pegged to a high theoretical number of claimants. Judges, meanwhile, are way too busy to bird-dog settled disputes. This distorted set of incentives produces unintelligible award notices buried deep in newspapers, burdensome forms to fill out, and short claim periods.

Solution: Reverse the economics of class-action settlements. Plaintiffs' lawyers should be paid after victims collect their

FRENCH JUSTICE Juries don't hear injury cases



A TALE OF TWO SYSTEMS

Western Europeans smoke, take Vioxx, and buy Firestone tires, too. But when they get injured, claims are handled far differently. Here's a simplified summary of the key differences between their system and ours...

	EUROPE	U.S.
MEDICAL EXPENSES	National insurance plans cover most health costs.	Private coverage means more uninsured citizens and higher personal exposure.
EMOTIONAL AND PUNITIVE DAMAGES	Payments for emotional distress restricted. Punitives nonexistent.	Potential for lottery-like winnings for a small percentage of victims.
JURIES	Payment rulings made by administrative judges with fee schedules.	Justice is dispensed by ordinary citizens. No scientific or business expertise required.
CONTINGENT FEES	<i>Qu'est-ce que c'est?</i>	Plaintiffs' lawyers rake in 33% to 40% of their clients' winnings.

... and how they play out for all involved

SIZE OF AWARDS	Much smaller. Even extreme emotional distress does not lead to larger awards.	Much bigger. Thanks to sympathetic juries, multimillion-dollar verdicts common.
SPEED OF PAYMENT	Faster. No adversarial process. Less room for pretrial maneuvering or appeals.	Slower. It can take years for victims to recover their money.
LAWYER POPULATION	Much smaller. Very few call themselves plaintiffs' attorneys.	More than 1 million, some 10% to 15% of whom represent plaintiffs.
PUBLICITY	Less elaborate pretrial discovery equals fewer smoking guns.	Battles that should be won in court are won in press—but public learns more.

money—not before. This would have two benefits. First, it would make them more aggressive about getting the word out to class members. Second, and more important, it would filter out a high percentage of the system's silliest claims. One of the main reasons people don't bother to collect class-action benefits is that they don't perceive any injury in the first place. And if people don't think they've been hurt, it's often a strong sign that the case isn't worth bringing.

A little-noticed provision of the recent Class Action Fairness Act instituted this pay-for-performance rule for coupon settlements, which account for approximately 10% of all class settlements. The reform now needs to be extended to the much broader world of cases in which people get cash or goods in kind—like toasters or tires.

An equally important move would target cases that require al-

most no work. Consider dozens of suits filed against Christie's International and Sotheby's Holdings Inc. over price-fixing in 2000. Before the U.S. Justice Dept. dug up plentiful evidence of a joint conspiracy to prop up the sales commissions that the two premier auction houses charged clients, the private filings were slam dunks. While the plaintiffs' lawyers helped distribute money to victims, they did not serve their typical 33% share of the take. So U.S. District Judge Lewis A. Kaplan of Manhattan came up with a creative plan for forcing plaintiffs' lawyers to for the job in a reverse auction. The firm that promised to pay the biggest sum to the victim won. This is one of the ways ever devised to ensure the tort system effectively fulfills its compensation function. More judges should follow Kaplan's lead.

2. Penalties That Sting

THE CHRISTIE'S-SOTHEBY'S story raises a point often overlooked: The players in the litigation system to resolve the problem are often judges, not legislators. Judges can figure out when attorneys in their courtrooms are acting in bad faith. In contrast, politicians can only police the system from afar by rewriting laws, which always produces unintended consequences.

One fix: Give judges stronger tools to punish renegade lawyers. Before 1993, it was mandatory for judges to impose

sanctions such as public censures, fines, or orders to pay for the other side's legal expenses on lawyers who filed frivolous lawsuits. Then the Civil Rules Advisory Committee (CRAC), an obscure branch of the courts, made penalties optional. This new rule is to be reversed, either by the CRAC or by Congress.

Simply rewriting the rules only solves part of this problem, though. An equally important step is for judges to rise to the challenge and use their disciplinary powers. For too long, the cozy, protect-the-guild mentality has protected exploitative attorneys from serious punishment. So the cost of filing baseless harassment lawsuits has never approached the rewards of cashing in on them. The tough regime should apply on both sides of the bar. Judges have also been far too relaxed about punishing defense attorneys who destroy documents—a tactic that's even more serious than filing frivolous cases.

Curb the Duplication

THE THIRD REFORM targets one of Corporate America's biggest complaints: duplicative litigation. This problem arises in a wide variety of settings. Think of the lawsuits involving cigarettes, Vioxx, or the Windows operating system. The companies at the center of the storms—Philip Morris (now Altria Group), Merck, and Microsoft, respectively—each faced administrative inquiries, individual cases, and class actions filed by private lawyers, state attorneys general, and federal regulators. The U.S. system encourages this type of overlapping enforcement—and it's O.K. if every player contributes something unique to the ultimate solution. But that isn't always the case. Earlier this year the National Highway Traffic Safety Administration an-

nounced that it was investigating alleged suspension problems with Dodge Durango trucks, plaintiffs' lawyers filed five class actions asking the company to recall the vehicles. Chrysler voluntarily agreed to do so—and then had to spend money fighting tort lawyers claiming credit for the move. Three of the cases have been dismissed.

Corporate America's preferred solution to the duplication problem is so-called preemption—getting Congress to declare that agency approval of, say, a particular drug blocks subsequent private litigation. That would be fine if agencies had perfect foresight. But as the Vioxx episode proves, they don't. "When you preempt, you make a decision about future cases for all time," says D. Bruce Hoffman, formerly deputy director of the Bureau of Competition at the Federal Trade Commission

IN THIS DEBATE, IT'S WAR BY ANECDOTE

When George W. Bush takes aim at the failings of the tort system, he likes to point out what he says are its huge economic costs. On Feb. 18, as he signed the Class Action Fairness Act into law, the President cited a favorite statistic: "Junk lawsuits have driven the total cost of America's tort system to more than \$240 billion a year—greater than any other major industrialized nation."

It's an attention-getting figure. But like every other number that's tossed around in this debate, it's misleading. Bush's source for his recent comment is Tillinghast-Towers Perrin, an actuarial consultant to the insurance industry. In a 2004 study on tort-system costs, Tillinghast tallied everything from no-fault fender-bender claims to the salaries of insurance company CEOs to calculate that the tort system as a whole is a \$246 billion enterprise. Junk lawsuits weren't even mentioned. "There's no way to split the number between junk lawsuits and legitimate lawsuits," says Russ Sutter, the primary author of the report Bush cited. "We've seen examples on both sides of the debate misstating numbers."

That might be because there aren't any good numbers to go on. As policymakers weigh profound changes to the nation's legal system, they're working largely in the dark. No one collects and aggregates data from all of the nation's 15,500-plus courtrooms. The result is a war of anecdotes waged by ideologues of all stripes—and an arms race to produce the killer statistic that will attract the media, sell the public, and shape policy.

Take the average size of medical-

malpractice payouts. The Physician Insurers Assn. pegs it at some \$350,000, based on information supplied by about half its members, representing 25% of the market. But the Consumer Federation of America, using claims data collected by the National Association of Insurance Commissioners (NAIC) from all 50 states, counters that the

LAWMAKERS ARE IN THE DARK

There's no centralized data bank to track lawsuits, so estimates of, say, medical-malpractice damages diverge wildly

The average size of payouts? Depends on whom you're asking

\$350

THOUSAND

Physician Insurers Assn.

\$30

THOUSAND

Consumer Fed. of America

average payment is closer to \$107,500. It's even lower—\$30,000—when the Federation factors in the 70% of medical-malpractice claims that are dropped or dismissed and result in no indemnity payment.

Medical-malpractice insurers also use their own claims data to show an increase in the number of million-dollar-plus awards. But they can't say for certain whether the trend is the result of growing economic

damages—to compensate for higher average wages and escalating medical costs—or the consequence of ballooning pain-and-suffering awards. If it's the former, a congressional proposal to cap pain-and-suffering payouts could be misguided. A September study by the NAIC concluded that existing medical-malpractice insurance data are useless for determining the makeup of payouts or the reason behind rising claims.

As for jury awards, are they really getting bigger? The Justice Dept.'s Bureau of Justice Statistics says median awards in civil torts have actually decreased, from \$65,000 in 1992 to \$37,000 in 2001, the most recent year for which the agency has numbers. But the bureau sampled data from only 45 of the nation's 3,100 counties. The study gives a fairly accurate picture of trial outcomes in urban courts, BJS statistician Thomas Cohen says, but "does it give a picture of trials in rural or semi-rural jurisdictions? No." And all measures of jury verdicts miss big awards that are cut down on appeal.

Another missing piece: More companies have begun to self-insure or rely on indemnity plans established by state governments—meaning they don't report claims or payouts to anyone. Consultant Tillinghast estimates that about 30% of commercial tort costs are covered by the self-insured alone, up from 6% three decades ago. No one knows in aggregate how those plans are faring.

When lawmakers debate changes to other major institutions, such as Social Security or the tax code, they rely on blue-ribbon panels and bipartisan task forces. The tort-reform polemic, in contrast, has been based on factoids and statistics drummed up by vested interests. Calling for a government study might sound like typical Washington stall tactics, but with each side accusing the other of lying, a study could turn down the heat—and allow a real debate.

—By Lorraine Woellert in Washington

and now in private practice. Winning preemption "should be a very steep hill [for companies] to climb."

A better solution is a package of more modest reforms. The first one would be eliminating punitive damages for injuries caused by products that have been approved by regulators. The long and involved process of winning over the FDA or NHTSA should, at a minimum, insulate managers from claims that they deserve huge financial penalties for wantonly disregarding the public good (unless executives lied to bureaucrats). A second idea is giving judges explicit authority to reject class actions that duplicate ongoing regulatory initiatives. That will require a mechanism for ensuring that judges find out whether an agency is reviewing issues raised in class actions—something that's missing now. The committee that sets rules for civil litigation, or Congress, needs to fix these problems.

4. Exiting the Tort System

THESE THREE CHANGES would solve many of the tort system's genuine problems, but not all of them. There are rare issues that need to be removed from the courts—with all of their elaborate procedural rules—and directed into specialized administrative tribunals. One of them, clearly, is asbestos. Aggressive plaintiffs' lawyers are overloading the judiciary with thousands of dubious cases that don't even involve sick people. Congress' plan to create a trust fund to handle this problem makes sense.

Asbestos is the easy case. The tougher one is medical malpractice. Evidence of massive systemic malfunction is starting to accumulate. Only about 2% of the people who are genuinely injured even bother to file lawsuits, according to most studies. When people do go to court, only 40% of every dollar spent on litigation goes to victims. Then there's the spreading damage to doctors. For some specialists, medical malpractice premiums can eat up between 20% and 50% of annual income. That's why neurosurgeons are avoiding trauma cases and orthopedic surgeons are eliminating emergency room calls.

The steady drumbeat of problems has prompted many physicians, lawyers, and politicians to support the idea of special health courts. They would have dedicated judges, a panel of neutral experts, and medically trained staff. Because pretrial discovery would be limited, the cost of filing cases would decline. The theory is that this would induce more injured people to make claims, and that they would get their money faster.

But there's a big trade-off—no emotional or punitive damages. To ensure consistency, health court awards would be based on a European-style damages schedule. In Britain, for example, damages paid for quadriplegia range from \$311,000 to \$387,000, depending on a patient's residual movement, depression, pain, and age. What's more, victims won't get to tell their story to a jury. That worries consumer advocates, who fear that the health-care industry would find a way to control these courts. "The jury is the only unit of government that is nonpartisan and not elected. It doesn't have to answer to anybody," says Barry Boughton, a lawyer with Public Citizen.

That's a powerful objection. Before reengineering American justice, we should get more information about the problem and experiment with some modest steps. One would be giving juries considering emotional damages guidance about what other juries have done in similar cases. Studies have shown that this would cut down on the unpredictable verdicts that torment



BUSINESS WISH LIST

Tort overhaul is high on the political agenda for the first time in years, with Corporate America pushing several bills through Congress this year.

➤ **MEDICAL MALPRACTICE** Legislation would limit pain- and-suffering payouts at \$250,000, cap attorney fees, and require courts to reduce compensation awards for expenses already covered by health insurance and the like. But the bill is no slam-dunk. For every doctor put out of business by malpractice insurance premiums, consumer advocates will have a horror story about a patient harmed by error or negligence.

➤ **ASBESTOS** Business, labor, and the trial bar have spent years trying to establish a \$145 billion fund to compensate asbestos victims and move tens of thousands of claims out of state courts. But the fragile coalition is splintering as the fix tries to be all things to all people. Disputes over the fund's financing and price tag will deep-six the effort.

➤ **FRIVOLOUS LAWSUITS** The Lawsuit Abuse Reduction Act would fine lawyers who file frivolous cases and require judges to refer repeat violators for disciplinary action. The measure is backed by heavyweights such as the National Federation of Independent Business and could be a dark horse this term.

➤ **OBESITY** The restaurant industry wants legislation to bar people from suing eateries for weight gain and associated health problems. The so-called cheeseburger bill doesn't have the heft to compete with higher priorities and probably won't win a floor vote.

—Lorraine Woellert

doctors and insurers. Another step: publicizing data on how many doctors have been sued for malpractice or disciplined by their states' medical boards.

These moves do not go as far as advocates like Comm. Good's Howard would like. But they surpass anything on the table. There is, ultimately, no perfect way to balance the interests of everybody who has a stake in the medical malpractice debate—or any of the other broad issues subsumed under the tort reform banner. Any rule changes that protect doctors and drugmakers, by definition, would limit the rights of some victims. The guiding principle for tort reform should be to target bad lawsuits as narrowly as possible. That's the only way to balance the enormous values at stake. ■

—With Lorraine Woellert in Washington and Michael J. Medel in New York

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A Linux Nemesis On the Rocks

SCO's lawsuit is floundering—and now the company faces regulators' scrutiny

TWO YEARS AGO, A TINY Utah company maneuvered its way into the biggest software battle on earth. On one side was mighty Microsoft Corp. Challenging the giant was the Linux operating system, built and maintained by legions of volunteer programmers around the world—and supported by none other than IBM. Standing between them was SCO Group Inc., a struggling software company in Lindon, a small town 30 miles south of Salt Lake City. While short on business, SCO held some potentially powerful copyrights. Partly funded by a hefty Microsoft license payment, SCO leveled a multibillion-dollar suit against IBM, charging that Big Blue had fed SCO-copyrighted software into Linux. This triggered fear and loathing in the fast-growing Linux community. A

court win for SCO, Linux fans feared, could bring its growth to a grinding halt. And so, SCO became one of the most vilified companies in the technology industry.

Well, the mouse that roared is barely squeaking these days. A string of recent setbacks raises grave questions about SCO's finances, its court case, and its management. In December, Canopy Group Inc., SCO's biggest investor, fired two of its top executives—who are also the chairman of SCO's board and a SCO director. Later, in a lawsuit, it accused them of overpaying themselves by at least \$20 million as Canopy execs—charges they have denied. On Feb. 9, U.S. District Court Judge Dale A. Kimball scolded SCO for failing to produce any evidence proving IBM infringed its copyrights. A week later, NASDAQ warned SCO that it could be delisted for failing to file its annual financial statement. SCO says it missed the

FEISTY "We're in pretty good shape," says CEO McBride filing deadline on issues relating to accounting of its common stock and executive compensation

As a result of adjustments to its accounting, SCO will be restating its earnings for the first three quarters of 2004, *Business Week* has learned. While the restatement won't change its net loss or cash balance for that year, they are likely to reduce cash position by \$500,000 or more in fiscal year 2005, says an insider.

What once looked like a mortal threat to Linux appears to be fading. As a result, the suit has become a nonfactor in corporate buying decisions. "I can't imagine how this will go anywhere," says Aleksey etz, chief information officer at Acme Corp., a Little Rock consumer-analysis company that uses Linux. Microsoft, which helped finance the lawsuit by paying \$13 million to SCO for a Unix license, claims that Linux, which is available free of charge, costs more to maintain than its own Windows operating system. That tactic doesn't seem to be working, either: In 2004, Linux server computer sales grew 51%, to \$4.9 billion, according to Gartner. Microsoft will not comment on SCO, but has said in the past that it bought a SCO license to ensure Unix worked with Windows—not as a way of financing SCO's suit.

Weak as it is, SCO has some staying power. Late last year the company crafted an agreement to cap its legal costs with its outside law firm, Boies, Schiller & Flexner LLP, ensuring that the law firm will continue to press the case without draining SCO's reserves. The agreement should leave the company with about \$100 million in the bank for fiscal year 2005.

Indeed, SCO Chief Executive Dale McBride remains optimistic. "It's a competitive environment we live in," says McBride. "but we're in pretty good shape." Thanks to heavy cost-cutting, SCO's core Unix server-software business is generating operating profit now and will continue to do so in 2005, he says. What's more, McBride says the release this summer of a major upgrade of one of its Unix products will help boost its sales. Still, he adds that SCO's growth prospects hinge on the outcome of legal efforts. They "will define how we win in this game," he says.

LITTLE EVIDENCE

SCO DODGED A LEGAL bullet when U.S. District Judge refused in February to grant IBM's request for a summary judgment. But so far, SCO has failed to produce evidence for the court, despite

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merous claims that it had ample proof of IBM misdeeds. In addition, nothing incriminating has shown up so far in 900 million lines of software code that IBM has turned over to SCO. "It is astonishing that SCO has not offered any competent evidence to create a disputed fact regarding whether IBM has infringed SCO's alleged copyrights," wrote Judge Kimball. Thomas C. Carey, a lawyer at Boston law firm Bromberg & Sunstein LLP who is not involved in the suit, says SCO's case is on the ropes. "The judge gave every indication that he is prepared to throw out the case unless SCO comes up with some surprising evidence," he says.

A SHRINKING CORE

SCO HOPES ITS CASE will be saved by further documents from IBM. In January, Magistrate Judge Brooke C. Wells ordered the computing giant to hand over an additional 1.1 billion lines of code, as well as information about revisions to the code and the names of 3,000 programmers who helped develop versions of AIX and Dynix, two of IBM's Unix-based operating systems. It will take SCO several months to review this code and depose IBM developers.

Meanwhile, analysts expect the company's core business to keep shrinking. For the fiscal year ended Oct. 31, 2004,

SCO announced sales of \$42.8 million—down 46% from the year before. Losses more than tripled, to \$16.2 million. For fiscal 2005, Decatur Jones Equity Partners LLC expects SCO to report an \$11 million loss on \$38 million in sales. As a result, SCO has been forced to cut staff. Last year, it laid off about 100 employees, a third of its workforce. With each layoff, analysts say its ability to produce and sell software is diminished. "This is a sinking boat," says Decatur Jones's Dion Cornett, the only analyst on Wall Street tracking SCO. McBride says that while his staff is small in numbers, it's high on engineering expertise.

Adding to SCO's uncertainties are the woes at Canopy Group, which owns 31% of its shares. In December, Canopy's board fired Chief Executive Ralph J. Yarro III and Chief Financial Officer Darcy G. Mott. The two men sued, alleging illegal dismissal. Yarro and Mott claim their compensation was approved by Canopy's board. McBride says they will remain on SCO's board pending the outcome of the dispute. Canopy lawyers say they are not trying to remove Yarro and

Mott from the SCO board at this time but some analysts say the feud could lead to changes in SCO's management strategy down the road. If new directors are appointed at Canopy's request, they might pressure SCO "to sell assets or force a settlement," says analyst Rob Enderle of market researcher Enderle Group.

SCO's prospects could become clearer in a few weeks. On Mar. 8 a judge will begin a hearing that could help clarify who controls Canopy. On Mar. 17, SCO is set to defend itself against delisting in a hearing before NASDAQ. Then on Mar. 18, IBM is supposed to turn over the new code and other material. The judge has said he will allow IBM to file a

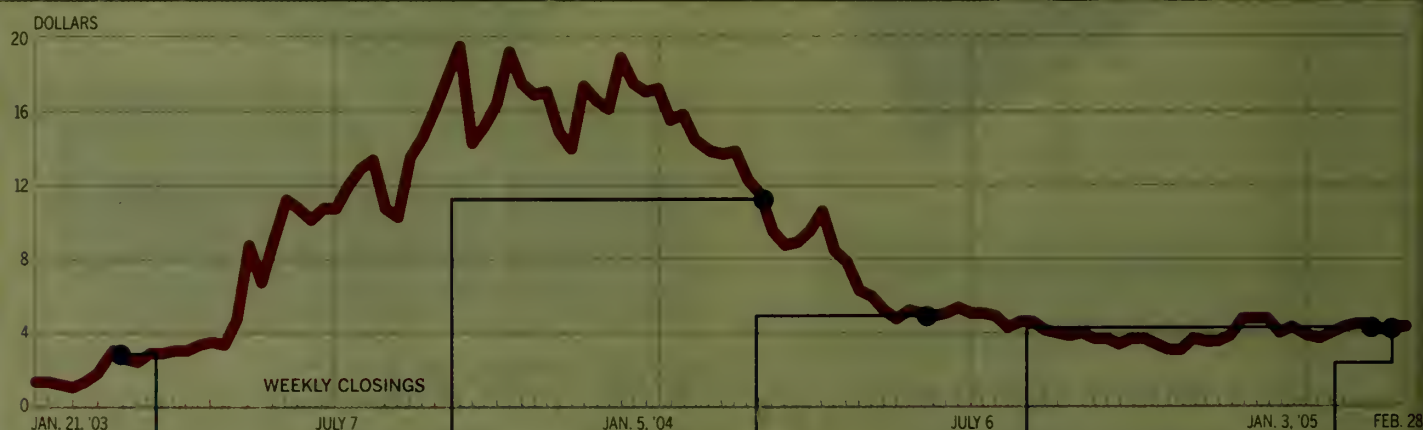
other motion to dismiss the case after the next phase of discovery is completed. SCO survives the next round, the case will probably drag on. It was originally scheduled to go to trial in early 2005. That was later shifted to November. But now it will be pushed back into 2006. This case may be long forgotten when and if, it ever goes to trial. ■

—By Spencer E. Ante, with Steve Hamer in New York

"This is a sinking boat," says SCO's sole follower on Wall Street

The Ups and Downs of a Tech Renegade

SCO Group launched a legal assault on the Linux operating system and its supporters, making itself one of the most hated companies in the tech industry. Now SCO, and its legal case, seem to be melting down.



MAR. 6, 2003

SCO Group, which has some rights to Unix, files a multibillion-dollar suit against IBM, alleging Big Blue misappropriated SCO's Unix technology and built it into Linux.

MAR. 3, 2004

After repeated threats to sue users of Linux, SCO sues DaimlerChrysler, alleging violations of its Unix contracts with SCO. SCO's main claim was later dismissed.

JUNE 10, 2004

For its second quarter, SCO reports a loss of \$15 million—more than three times what it lost a year earlier—and a 50% drop in revenues. Its stock falls 10%.

FEB. 9, 2005

A federal judge refuses to throw out its case against IBM but scolds SCO for failing to produce proof so far that shows IBM infringed on SCO's alleged copyrights.

FEB. 16, 2005

SCO receives a notice from NASDAQ indicating that it may be delisted from the exchange for failing to file its financial reports in a timely fashion.

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TiVo: Going, Going...Pause

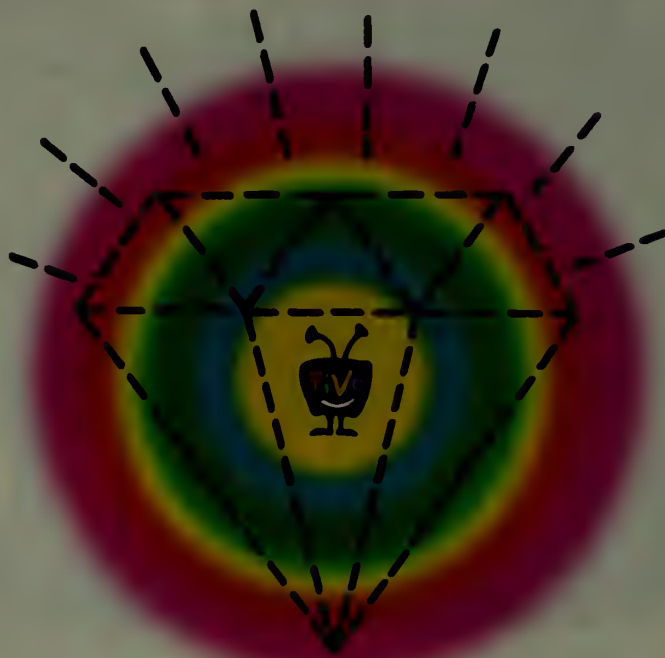
The market thinks it's on the block, but the company has other plans

THE HARDEST JOB IN headhunting might be filling the CEO job at TiVo Inc. The struggling Silicon Valley icon is looking for a new chief executive as the current boss, Michael Ramsay, is slated to move into the chairman post this June. But the market seems to be betting that the innovative company—the pioneer in digital video recorders that pause and record live programming and skip commercials—will be sold before then. The logic? TiVo's market cap is only \$336 million. Take away the \$150 million of cash on hand, and the company's valued at less than \$200 million. TiVo's sagging stock has jumped 16% since Feb. 14 on hopes that a media or electronics power—Sony, Time Warner, even Apple—will buy the money-losing TiVo for its brand and software smarts.

Expectations aside, there are plenty of reasons TiVo isn't likely to hook up with a suitor anytime soon. Fact is, for all of its passionate followers and its legendary ease of use, TiVo does not fit neatly into the business plans of industry giants. And it threatens to undermine revenues and upset relationships with Hollywood. The upshot: For most of the would-be suitors, marrying TiVo would mean rethinking their business.

Consider TiVo's latest scheme, announced in January. By early next year, the company plans to update software on its boxes so that subscribers can use the Web to download and store movies. TiVo also plans to provide digital links to other partners, such as Netflix Inc., the DVD-

rental-by-mail pioneer. If Comcast Corp. or DirecTV Group Inc. operated this service, it would likely compete with their pay-for-view and premium channels like HBO. And they would face pins-and-needles negotiations with Hollywood before implementing a TiVo system that lets customers download shows to notebook PCs and portable video players.



Instead, DirecTV, Comcast, Time Warner and others have chosen less costly hardware from TiVo competitors such as Motorola, Scientific-Atlanta, and News Corp.'s NDS Group. These products are tailored more to the demands of cable and satellite providers, and less to the end-users. How so? They offer premium options, such as downloading out-of-town sports or outtakes from *American Idol* but prevent users from surfing the Internet for programming. It's a pared-down serv-

ice, but their customers, unlike TiVo, don't have to buy a box.

Sony and Apple also have reason to keep their distance. Both companies already have strong brands and are unlikely to develop their own DVR technology, say analysts. One company that could use TiVo's brand is Korean TV and top-box maker Humax Co. In a bid to boost its own brand in the U.S., Humax partnered last year with TiVo to roll out DVD recorders that include TiVo software. This year, Humax plans to market a 19-inch LCD TV and new portable device loaded with the TiVo software. Buying TiVo could give Humax ties to upscale buyers. But for now, a Humax spokesman says, the company is not interested.

HANG ON FOR THE RIDE

FOR THEIR PART, TiVo execs and board members maintain that the company has a viable future—and is not courting suitors. In January, TiVo hired Silicon Valley Howard Fischer Associates International to find a new CEO to run TiVo's multimedia plan and sell the company's vision to Wall Street. The new exec will be expected to keep TiVo's share of the DVR market at between 25% and 30% as the digital recorder set-top-box biz grows from 10 million units last year to a projected 45.5 million units by 2009. "The good news is the category is growing like crazy," says TiVo board member Geoffrey Yang, a founding investor in TiVo. "[But] it's very difficult to maintain share when you're an industry leader."

The next CEO stands to ink a lot of red ink. After spending \$50 million last year to lure new subscribers with rebates and ads, TiVo is expected on March 1 to report losses for the year ending \$85 million on revenue of \$107.2 million. That's nearly three times the bleeding of a year earlier. Analyst Dan Ernst of Hudson Square Investment search Inc. expects TiVo to inch into the black this year, with earnings of \$1.5 million on sales of \$362.4 million.

If TiVo's Net strategy takes off, the company still has a chance as a star alone player. That's a sobering thought for the TV giants and studios. In fact, given the disruptive potential of TiVo, maybe one of the titans will spend a few hundred million to buy it after all—only to kill it. ■

—By Cliff Edwards in San Mateo, Calif.

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They make shoppers happy, but they can distort retailers' performance measures

LOYALTY PROGRAMS, GIFT cards, and other come-ons aimed at keeping shoppers hooked on a particular retailer are spreading faster than word of a fabulous bargain in aisle 5. That's good for consumers because they get better deals, and it's good for retailers because they make more sales. But it may not be so good for investors.

As these programs multiply, investors are finding it harder to size up a retailer's true financial picture. That's because there are no hard-and-fast rules for how retailers should handle the accounting for these incentive programs. Retailers must make assumptions about how many customers they think will use the gift cards they receive or redeem the loyalty points they earn on their purchases. Of course, for retailers, the fewer who do, the better—and those flexible assumptions can be used to manage earnings. On top of that, retailers are making different calls on where to account for this money in their financial statements. This can distort closely watched measures such as revenues, same-store sales, and profit mar-

gins, thereby making comparisons misleading, said Michael C. Gyure, a forensic accountant at FTN Midwest Research, in a report last year.

Compounding the problem, retailers offer scant details on these programs, making it nearly impossible to gauge their impact on results. This concerns investors because the programs are becoming a huge profit center for retailers. Gift-card sales alone are expected to top \$95 billion this year, up more than 50% from just \$61 billion two years ago, according to Raritan (N.J.) market researcher Pelorus Group. Loyalty programs are harder to track, and analysts say they don't have reliable statistics.

Meanwhile, the Securities & Exchange Commission is investigating at least one retailer over these matters, people close to the agency say. The SEC declines to comment or say which one.

MANY TIES THAT BIND

AS THE POPULARITY of incentive programs explodes, retailers keep coming up with variations, which further complicate the accounting. In addition to standard gift cards that consumers purchase, there



are others that retailers hand out in turn for certain purchases, say, one \$100 for buying a \$1,000 TV. Consumer electronics chain Best Buy Co. is one retailer that does this. Similarly, shoppers can get discounts by making purchases that earn them cash-like vouchers that can use for future purchases. Those offered by youth retailer Pacific Sun of California Inc., among others. There are a growing number of loyalty programs in which consumers earn points that are good for future discounts. Best Buy rival Circuit City Stores added such a program last fall. At the same time, clothing retailer Men's Wearhouse sharply expanded its Perfect Fit loyalty program, which awards shoppers \$100 toward a future purchase for each \$1,000 they spend.

The rapid proliferation of gift and reward programs has caught the accounting profession flat-footed. "The

Warm and Fuzzy Numbers?

While loyalty programs and other customer incentives can buttress sales, financial results become tougher to discern. That's because retailers...

» Can adjust their earnings via judgment calls on how many gift cards, points, or bonus dollars they figure shoppers won't redeem

» Account for gift cards in different ways, making it difficult for investors to compare retailers on revenues, same-store sales, and margins

» Disclose little about these incentive programs in company financial statements, so investors have few means to assess their impact

Data: BusinessWeek



t of gray," says Matthew Mc-
n, a senior manager at Price-
waterhouseCoopers. The ac-
counting industry's rulemaking
body, the Financial Accounting
Standards Board, is expected to
address this issue as part of a
review it's conducting of
how companies account for
revenue.

the lack of rules certainly
gives retailers plenty of leeway.
When Best Buy started its "Re-
ward Zone" incentive plan in

2003, shoppers earned \$5 on each \$125
they spent, and the money had to be ap-
plied to other purchases within 90 days.
Because Best Buy had no track record of
how many of these dollars would be
used, it deducted all of the Reward Zone
earnings from revenue in the first quarter
of the program. But in the next quarter,
Best Buy said it could figure out how

The spread of loyalty plans has caught accounting professionals flat-footed

year. It defers all revenue from gift-card
sales. But if a card went unused for two
years, the company used to deduct \$2 a
month from the value of the card. Then,
in the quarter ended in February, 2004,
it dropped the dormancy fee and began
decreasing its liability, based on its
record of past redemptions. That added
2¢ a share in a Christmas quarter in

many dollars wouldn't be
redeemed and cut its liability
accordingly. The move
added 2¢ a share to the
company's before-tax earn-
ings and enabled Best Buy
to hit analysts' forecasts of
37¢ a share to the penny.
Spokeswoman Susan
Busch-Nehring says Best
Buy wasn't trying to man-
age its earnings.

What would better ac-
counting have called for?
Charles W. Mulford, an ac-
counting professor at Geor-
gia Institute of Technology's
Dupree School of Manage-
ment, and other account-
ants say gathering a year's
experience before making
the adjustment, rather than
just one quarter's, would
have been more appropriate.
That's especially true, he
adds, because Best Buy's
business is highly seasonal
and it had yet to run the
program during the peak
Christmas quarter. Indeed,
for the first quarter of the fis-
cal year that began on Feb.
29 of last year, Best Buy dis-
closed that it hadn't set
aside enough money for re-
demptions, forcing it to sub-
tract more from revenue. In
October, Best Buy raised the
minimum purchase cus-
tomers must make before

earning \$5, from
\$125 to \$150, a
move that helped
earnings for the
Christmas season
because Best Buy
needed to defer less
revenue. Best Buy
says it was being
conservative in its
accounting.

Rival Circuit City
boosted earnings by
adjusting its gift-
card liabilities last

which it beat analysts' forecasts by 10¢.
Spokesman William Cimino says the
company wasn't trying to manage earn-
ings and that it made the change be-
cause of strong opposition to the fees
from state governments.

All the same, the change spruces up
one of Circuit City's key performance
measures. The chain now uses the money
it no longer defers to cut expenses, even
though a near-consensus in the account-
ing profession recommends counting
that money as revenue instead. "It relates
to sales made, not the expenses of run-
ning the business," says Georgia Tech's
Mulford. Circuit's method helped reduce
selling expenses as a percentage of sales
for fiscal 2004, one bright spot in a year
marred by falling revenues.

A NICE LITTLE BOOST

LOYALTY-PROGRAM accounting also can
be all over the map. Talbots Inc. counts
the liabilities from its Classic Awards pro-
gram—in which holders of Talbots credit
cards earn \$25 for each \$500 they
spend—as a selling expense. Talbots' re-
venue and same-store sales would be low-
er if it subtracted the liabilities from re-
venue, especially when it offers double
points to drive sales. While both methods
result in the same earnings, the Talbots'
way does exaggerate revenue. Men's
Wearhouse counts the liability as a cost of
goods sold. This reduces gross margins
but makes revenue and same-store sales
higher than they would be otherwise.
Neither chain would comment on why
they do the accounting this way.

Other retailers apparently agree with
accountants that taking the liabilities out
of revenue is the best approach. In its
most recent quarter, luxury retailer
Neiman Marcus Group Inc. switched to
that method. Previously, it had accounted
for its loyalty program the same way Tal-
bots does.

Meanwhile, rival youth retailers Too
Inc. and Pacific Sunwear print in-house
money for their incentive programs, but
neither discloses anything about that in
its accounting. Shoppers earn \$25 in Too
Bucks or Pac Bucks for each \$50 they
spend. But to use that currency, shop-
pers must drop at least another \$50 in
the stores within a set period of time.
Neither chain fully explained how the
accounting is done when asked for fur-
ther details.

For investors the lesson seems clear: It
may be more rewarding to shop in chains
with generous incentive programs than to
buy into their convoluted accounting. ■

—By Robert Berner in Chicago



Bare Bones, Plump Profits

ING Direct is now the largest online bank, and competitors are starting to pile in

ING DIRECT FLOODS MAILBOXES with \$25 checks for signing up. It operates a chain of trendy cafés. And its favorite color is orange. Is this any way for a savings bank to behave?

For an online bank that opened in the U.S. less than five years ago, so far it is. In that time, ING has collected 2.2 million U.S. customers and \$29 billion in deposits. No mystery there: the bank aims to pay the highest rates on savings accounts, 2.6% now, vs. 0.56% for the average money-market account at a bank. And lots of money goes into making sure everyone knows it. Last year, ING Direct, a division of Dutch financial-services giant ING Group, became the largest online bank—passing E*Trade Bank—and the fourth-largest thrift in the U.S., according to Charlottesville (Va.)-

based research firm SNL Financial.

Paying high rates? Spending tons on marketing? Seems like a recipe for red ink. Instead, profits are rising. ING Direct's U.S. division (it also operates in eight other countries) says it earned a pretax profit of \$250 million last year, up from \$110 million in 2003. The high-volume, low-margin business depends on using online efficiencies to offer a bare-bones service to low-maintenance customers. The bank doesn't offer checking accounts—that costs too much—and has

almost no bricks and mortar, just four of the cafés that promote the bank, in New York, Philadelphia, Los Angeles, and Wilmington, Del. What's more, a converted Wilmington warehouse serves as its U.S. headquarters, in contrast with its parent's digs in a gleaming sneaker-shaped Amsterdam structure known as "the shoe." Says

HIGH-VOLUME MAN Deposits under Kuhlmann rose to \$29 billion

Arkadi Kuhlmann, who runs ING Direct's U.S. division, says, "We can't be average and glitzy."

we might as well be retro and unique

But ING Direct isn't so singular anymore. Attracted by the Dutch invasion, competitors are crowding into the market. MetLife launched an Internet bank in late 2002 and has been heavily promoting its high rates—2.5% on savings. New York's Emigrant Savings Bank opened one in January, is pushing a 3% rate.

TIGHTER AND TIGHTER

RISING SHORT-TERM interest rates present another hurdle, even though they're likely to attract more customers. Because long-term rates aren't climbing at the same pace, income from ING loans and investments, mostly in mortgage securities, won't rise as fast, squeezing the bank's already tight profit margins. Many large banks delay hiking rates they pay on deposits to get more mileage out of rate spreads, but online banks don't have that luxury, says L. Reinford, an analyst at SNL. ING Direct's Kuhlmann says its customer-attraction rates are half that of other banks, but "ing rates will put that to the test."

One more challenge: ING Direct is trying to expand into new products to keep growing. It is ramping up its mortgage business and next month will air a minute TV infomercial promoting adjustable-rate loans. But for other Internet banks, such as Britain's Egg, diversification brought trouble. "Now that they've captured a lot of customers, the key is to cross-sell and increase customer loyalty," says Keith MacDonald, a partner at consulting firm Capco.

Not to worry, says Kuhlmann, a smooth and seasoned banker who has run the U.S. division since it began. He points out that all banks must deal with the shrinking spread between short- and long-term rates. And ING Group Chief Executive Michel Tilmant expects new U.S. rivals to attract more customers to online banking and ING Direct. "I feel we have a head start," he says. The biggest concern is making sure the bank keeps paying attention to basic details as it continues to grow quickly. It's a concern other banks would love to have. ■

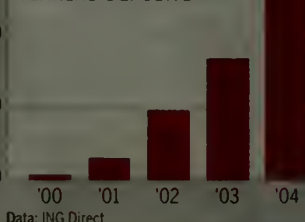
—By Amey Stone in New York

MONEY MAGNET

High rates on savings have drawn a flood of deposits

BILLIONS OF DOLLARS

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BusinessWeek online For a Q&A with ING's Arkadi Kuhlmann, go to www.businessweek.com/extras

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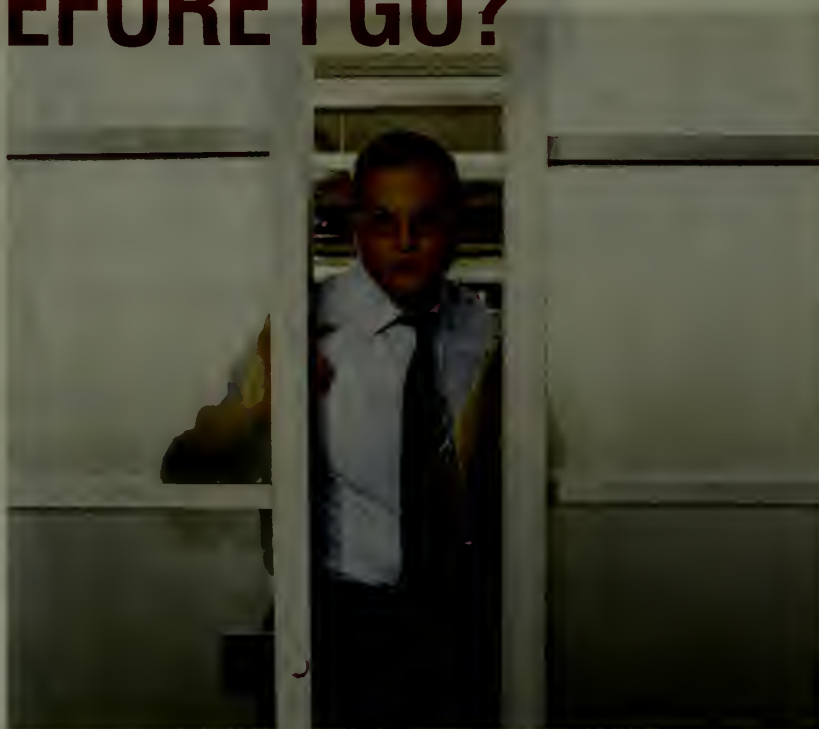
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Don't Blink—You'll Miss the IPO

Buyout firms are taking companies public soon after acquiring them—and raking it in

BUYOUT FIRMS WANT their money back—now. Taking a company private and spending years remaking it before cashing out seems so 1980s. Instead, impatient firms are taking companies public just months after they buy them.

Consider the recent rush to go public by satellite service providers. Less than a month after a consortium of private-equity firms, including Apax Partners and Apollo Management, finished taking Intelsat private, the company began jawboning investment bankers in February about going public. Intelsat, Apollo, and Apax would not comment. Five months after a group of buyout firms, including Kohlberg Kravis Roberts and Carlyle Group, bought PanAmSat, the company registered for an initial public offering in December. All three declined to comment.

That sort of fast-tracking is quickly spreading across industries. In February, Leonard Green & Partners LP took flower delivery company FTD Group Inc. public just less than a year after it went private. Nine months after Blackstone Group Inc.



took industrial chemical maker Celanese Corp. private, the company went public in January. And five months after a consortium led by Blackstone picked up coal producer Foundation Coal Holdings, the company did an IPO in December. Blackstone points out that it still has large investments in both companies and continues to work closely with their management teams.

What's going on? The trend is the latest twist in an escalating battle on Wall Street between buyout firms and their hedge-fund rivals. Hedge funds have recently started encroaching on the buyout firms' territory, buying controlling stakes in companies rather than just picking up some shares. That has prompted buyout artists to complain that the hedge guys don't have the patience to turn around a company. Now, though, some buyout firms are dis-

playing signs that they're the ones developing an attention deficit disorder.

The main driver is the robust demand for IPOs of companies with stable cash flows and high dividend payouts. But the performance of these speed-of-light offerings has been mixed. Rising commodity prices are lifting the stock of Foundation Coal, which has topped the Standard & Poor's 500-stock index since it went public. But Celanese is trailing the benchmark index.

Investor returns pale in comparison with the money buyout firms are raking in from some deals. For example, FTD stock price is up 4% since its IPO even though the S&P 500 has been flat. By contrast, Leonard Green reaped twice its initial \$183 million equity investment in FTD when it took the company public in February. Most of the proceeds from FTD's \$200 million IPO—\$198 million—went to buy back preferred stock from Leonard Green and to terminate its management-services agreement with the firm. Green's remaining 54% stake in FTD, including a \$30 million chunk it bought at the time of the IPO, is worth about \$200 million.

CLEVER ENGINEERING?

SOME INVESTMENT bankers view the buyout firms' race to market not so much as a giddy rush to the exits but rather as an integral part of corporate turnaround. For example, some companies may use their newly issued stock as currency to make acquisitions in consolidating industries. "Buyout firms are taking advantage of

window of opportunity, but they will soon own a meaningful piece of the companies," says Ros Stephenson, a managing director at Lehman Brothers Inc. who advises buyout firms.

Still, critics say the trend raises questions about why the companies are going private in the first place. They charge that some deals look a lot more like clever financial engineering than traditional turnarounds. Says Daniel S. Loeb, founder of hedge fund Third Point Management LLC, "certain private-equity firms have themselves out as having specific management expertise, but many just do basic blocking and tackling that any second-year MBA could perform." Even as long as the market rewards cosmetic improvements, buyout firms will follow the money. ■

—By Emily Thornton in New York

Fast Track

A robust demand for IPOs is driving private-equity firms to flip companies back onto the market within months:

COMPANY / INDUSTRY	LENGTH OF TIME (MONTHS)
FOUNDATION COAL coal mining	5
PANAMSAT communications services	5*
CELANESE industrial chemicals	9
FTD GROUP flower deliveries	12

* Taking into account

Data: RR Donnelley Private Equity Report

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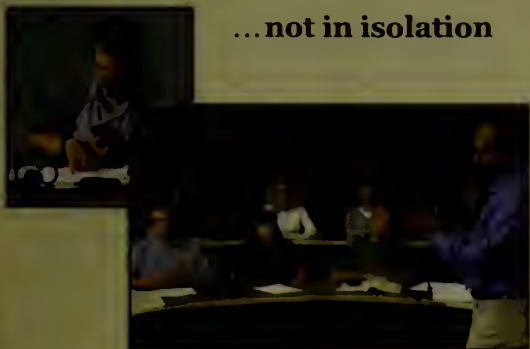
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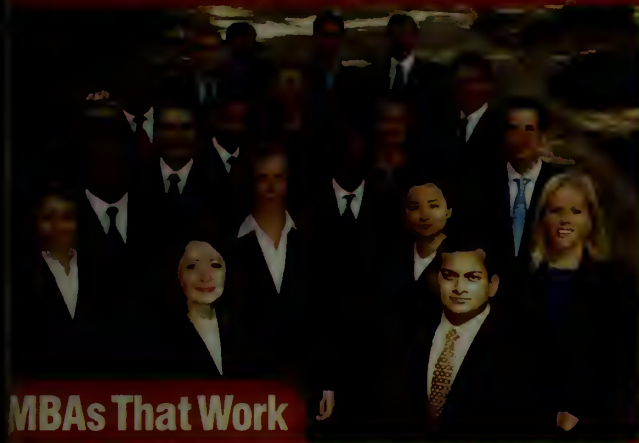
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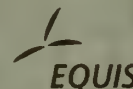


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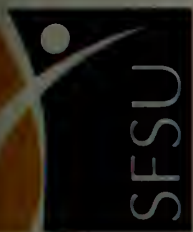
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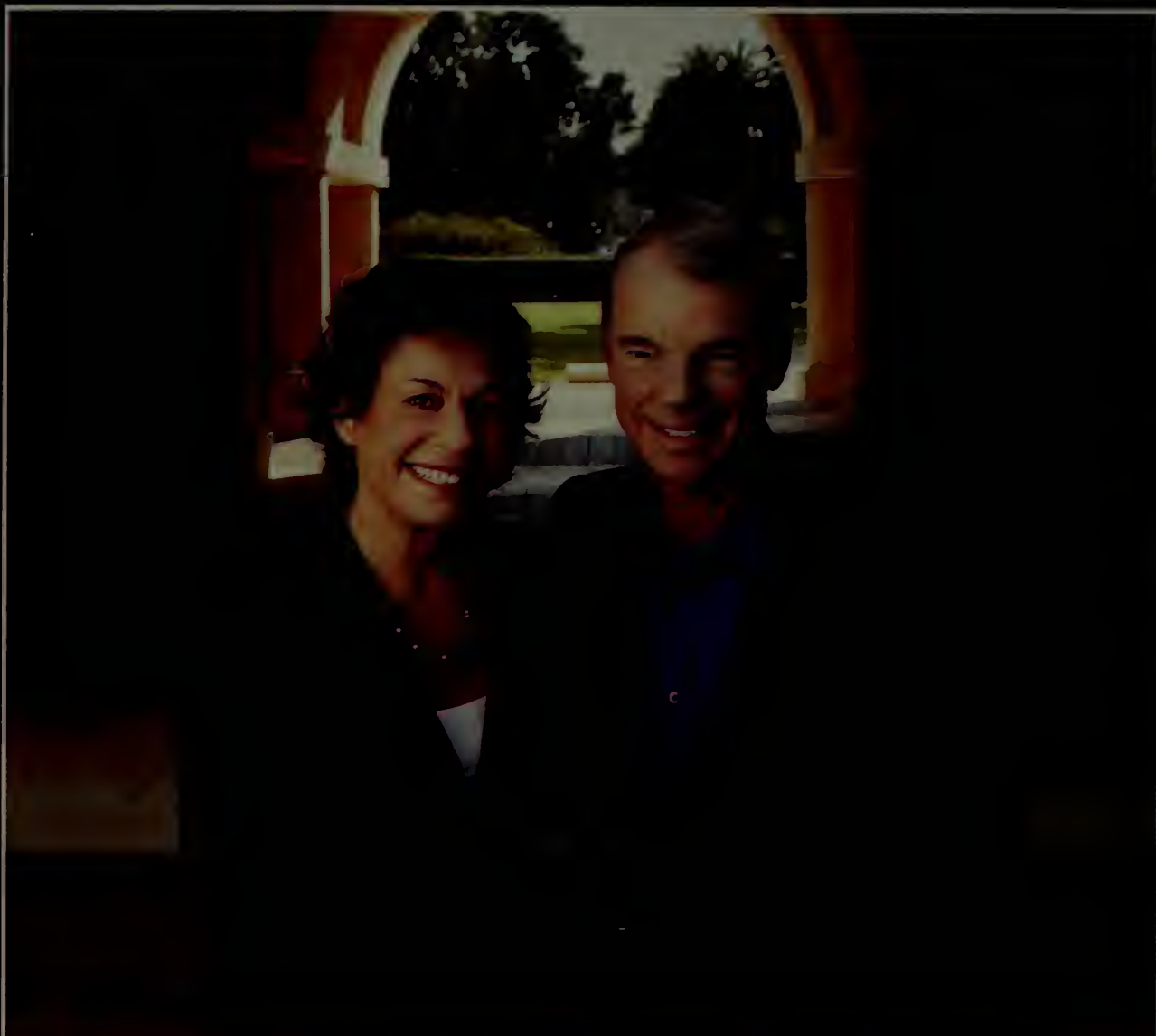


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The Machine of A New Sole

Adidas' new shoe is no gimmick. At \$250, it's no bargain

THREE YEARS AGO, A TRIO of engineers for adidas-Salomon began toiling away in a windowless boiler-room-turned-secret-workshop beneath downtown Portland, Ore. Their goal: to create the first intelligent running shoe, one that would use an in-sole computer to adjust its heel cushioning in real time according to changes in the running surface. "We knew we would have to rewrite the book," says Christian DiBenedetto, chief engineer at the North American headquarters of Adidas. "But we knew it would be massive if we could pull it off." Well, maybe. Even if Adidas can make a viable computerized shoe, the unknown is whether enough consumers will value the breakthrough. The Adidas \$250 high-tech wonder, hits store shelves this month as a big gamble that the German company can redraw the lines between itself and archrivals Nike Inc. and Reebok International Ltd. The heel of the aerodynamic shoe are a wafer-thin sensor and magnet that monitors the amount of shock applied to the foot and adjusts the footbed 1,000

times per second. Adidas executives believe the shoe could be their iPod, a technology so ready for prime-time that it can be adapted to the company's basketball and soccer shoes and eventually enter the profitable league of "gotta-have" sneakers among urban youth. Says a hopeful Erich Stamminger, CEO of Adidas North America: "This is the biggest thing to hit this industry in decades."

LIMITED RELEASE

BUT ADIDAS COULD just as likely be stepping off a cliff. No one knows if even serious runners are ready to pay \$250 for a shoe—more than 50% above the next most expensive sneaker on the market. Nike Air Jordans, at \$150 to \$175 a pair,

only staged a comeback last year, after two years of sinking sales. Adidas won't divulge its capital investment in Adidas 1. But analysts say production is complicated and that the new sneakers will cost four or five times as much to make as a normal shoe. Because of that, production will be less than 10,000 this year to drive exclusivity and hedge Stamminger's bet.

Adidas is following the example of German luxury auto makers, BMW and Mercedes-Benz. The carmakers introduce expensive technology, like navigation systems, in high-priced models, establish credibility and critical mass, and then push the technology, if it's accepted, into lower priced models.

But shoes aren't cars, and Adidas can't



RESPONSIVE The Adidas 1's sensor adjusts cushioning for different surfaces

Getting a Step Up at Adidas

To close the gap with No. 1 Nike, the company has been turning up the heat:

NEW SHOES

Its Adidas 1 shoe will be the first in the world to have a computer inside adjusting the footbed. The company has other new models that claim advances in cooling and cushioning.

BUILDING BUZZ

The year-old "Impossible is Nothing" ad campaign has drawn critical acclaim. Snaring international superstar David Beckham helped Adidas maintain its lead in soccer shoes.

BIG DEALS

Became a major sponsor of Major League Soccer, getting exclusive ad rights for the U.S. TV feed of the 2006 World Cup. Signed hot designer Stella McCartney to create a women's clothing line.



afford a misstep. Outside the U.S. it is the clear rival to Nike, and holds a dominant 35% share of soccer-shoe sales. But the German company slid to No. 3 in the \$8.3 billion U.S. branded-athletic-shoe market in the late 1990s, thanks to weak ad campaigns and unfashionable new products. Adidas held a 9.1% share in 2003 and 2004, vs. 12% for Reebok, and 36.4% for a resurgent Nike.

Stamminger, who took over the U.S. division last year, adding to his global marketing title, is making changes that have retailers more interested in Adidas these days. Designs for the U.S. are hatched in Portland now, reversing years of designs that played in Munich and bombed in Missouri. In addition to out-bidding rivals for NBA pitchmen Kevin Garnett, Tracy McGrady, and Kwame Brown, he secured exclusive ad rights for the U.S. TV feed of 2006 World Cup Soccer. And Adidas recently signed hot fashionista Stella McCartney to design new lines of sport clothing.

POSITIVE FEEDBACK

RIVALS NIKE AND REEBOK have taken notice but are skeptical that Adidas 1 will be another Air Jordan. "We think technology that changes the design of the shoe rather than just the function, like our pump that obsoletes laces, is where the breakthroughs come," says Reebok Chief Marketing Officer Dennis Baldwin. Both rivals are developing their own "smart shoes," though they say they aren't going as far in applying silicon chips to the problem. One pitfall stemming from the hardware is added weight. A size-9 Adidas 1 weighs 15.3 ounces, while most top-end running shoes weigh between 10 and 14 oz. And if anyone obsesses about a few ounces, it's influential consumers in the \$4.9 billion running-shoe market.

Nevertheless, Adidas is pumped by nine months of positive buzz that preceded the new shoe's launch. *Runner's World* gear editor Warren Greene, for example, says Adidas 1 delivered the goods on his extended test. "The overall fit and feel and responsiveness and the ride of the shoe were all positive."

Stamminger delivered a mild rebound in 2004 when Adidas' sales rose 2% last year after two years of flat sales. Now he is projecting sales will grow by 5% to 10% this year and hit double digits next year, thanks in part to Adidas 1. Those are heady expectations for a sneaker priced in territory Michael Jordan couldn't reach, even on his best day. ■

—By Stanley Holmes in Portland, Ore.



SPELLINGS
"The recipe
is right,"
she says

No High Schooler Left Behind

How will Education Secretary Spellings extend Bush's program to the upper grades

MARGARET SPELLINGS got high grades as the architect of President George W. Bush's 2001 No Child Left Behind school reform. Her saucy Texas witticisms and steel-trap mind have earned friends for the former White House domestic policy chief as diverse as Bush political guru Karl C. Rove and liberal lion Senator Ted Kennedy (D-Mass.)—as well as the moniker "La Margarita" from the President. Kennedy, usually stingy with praise for Republicans, describes the 47-year-old policy wonk as

"a consistent champion for improving and strengthening public education." Now that Spellings is settling into her job as Education Secretary, she's learned that even a straight-A student may easily ace her next exam.

As the longtime Bush aide tries to extend education reform to the next level—by tending No Child's testing requirements into high school—she faces resistance that crosses the political spectrum, stretches from Washington to dozens of state capitals. To succeed, Spellings will have to overcome a backlash from the divisive tenure of predecessor Rod Paige, who riled state legislatures over what



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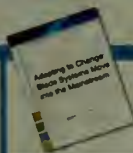


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considered inflexible implementation of new national standards and personal disputes with political foes. "She's going to have her hands full," says John F. Jennings, president of the Center on Education Policy, which keeps tabs on education reform.

BALKY REPUBLICANS

INDEED, TOUGH challenges lie ahead for an education expert who has earned a reputation for bipartisanship as she worked for Democrats, Republicans, and school boards over the past 20 years. Prominent pro-reform Democrats, including Kennedy and Representative George Miller of California, are unwilling to team up with Bush again, burned by what they view as a gaping \$39 billion shortfall in funding for No Child Left Behind. What's more, about 50 conservative House Republicans, many of whom re-

master reading, math, and science skills—will cost a bundle. And the main source of funding, a \$1.2 billion cut in vocational education programs, is seen by some on Capitol Hill as robbing Peter to pay Paul. "You have both a political problem and a funding issue," says Michael N. Castle (R-Del.), chairman of the House subcommittee on education reform. "There is insufficient support in the House of Representatives now to pass it."



A School Project That's Hard to Ace

Even as many states and parents complain about President Bush's 2001 No Child Left Behind law, new Education Secretary Margaret Spellings is pursuing an ambitious second-term agenda to expand it into high school. Her plans:

TESTING Require school districts to test high school students three times, instead of the current one, by the 2009-10 school year. Under the plan, every student would be tested annually for basic skills from grades 3 through 11.

UNDERACHIEVERS Add \$1.2 billion for programs to help "at-risk" students meet the No Child act's higher standards. Also, quadruple, to \$120 million, a federal math and science partnership to help struggling students reach grade-level achievement goals, plus a \$175 million increase in a program to improve teens' reading skills.

REPROGRAMMING AID Eliminate or dramatically reduce funding for about 50 Education Dept. programs, with the biggest cuts coming in aid to politically popular vocational education. The money would be rechanneled to larger special education grants to states, a 4.7% increase in aid to help poorer school districts, and a teacher incentive fund to attract teachers to low-income schools.

luctantly backed Bush's K-8 reforms out of first-term loyalty, say they are unwilling to extend the federal reach in education. "However well-intentioned, one more unfunded mandate from Washington will not cure what ails our local schools," says Representative Mike Pence (R-Ind.), chair of the conservative House Republican Study Committee.

Adding to the Education Secretary's woes, the Administration's new No Child proposals—which include three years of high school testing and additional aid to assist students who are struggling to

That's not the kind of pessimism the business community wants to hear right now. Prominent executives have been peppering state and federal lawmakers in recent months with a blunt message: High school students must improve their math, science, and writing skills for the U.S. to remain competitive in the global marketplace. Microsoft Corp. founder William H. Gates III, speaking on Feb. 26 at a national education summit in Washington, D.C., damned U.S. high schools as "obsolete," saying its education model is so outdated that it's "like trying to teach

kids about today's computers on year-old mainframe."

Execs recite a long list of high school failings: Its graduation rates leave them ranked 16th among 20 industrial countries and rivals such as India and China produce more engineers. "We have plenty of graduates. Now we need some solutions," says Prudential Financial Inc. CEO Arthur D. "Art" Ryan, co-chairman of Achieve, a bipartisan education reform partner-

between business and government.

While some 30 governors are working on state-based reforms, Spellings wants Congress to act, starting by requiring all pupils to undergo skills tests each year from 3rd through 12th grades. The Bush budget includes a 4.7% increase in federal aid to help poorer school districts and expanded incentives to attract teachers to poor schools. Says Spellings: "The recipe is right. We need to extend it into high school."

It certainly won't hurt Spellings' sales pitch that she

TEAMMATES But Bush and Spellings face heavy opposition

product of suburban Houston public schools. The University of Houston political science journalism major

also the first Education Secretary to have school-age children—daughters Abigail and Grace. "She knows the imperative of standards-based reforms and that education is fundamentally a state responsibility," says Governor Bob Taft (R-Ohio).

Despite Spellings' credentials and warm relationship with many state lawmakers, she faces skepticism from the contentious round of No Child Left Behind. State lawmakers around the country are demanding more flexibility in meeting the tough standards set by the feds—something Spellings says she understands because "I've... been in the other guy's shoes."

The education boss will have to use all of her schmoozing skills to reassure doubters. "Obviously, change is hard," she acknowledges. "[But] we're here for the long haul with this law." That mixture of firmness and flexibility is something educators, CEOs, and lawmakers alike see as a welcome change in a political capital. ■

—By Richard S. Dunham in Washington, with William C. Symonds in Boston

BusinessWeek online For a Q&A with Education Secretary Margaret Spellings, go to www.businessweek.com/extras

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MBA Family Values

B-schools find it pays to make students' partners—and kids—feel welcome. **BY JENNIFER MERRITT**

CRAIG MITCHELL KNEW EXACTLY what he was looking for in a business school: a curriculum that would make possible a career change from accountant and business-software consultant to investment banking, a placement office that had good relationships with Wall Street firms, and a community where his wife and three daughters would be comfortable and welcome. After the 35-year-old Castle Rock (Colo.) resident narrowed his choices to seven or eight schools that would best serve his career, thoughts of his family's happiness whittled the list further. His final choice: University of North Carolina at Chapel Hill's Kenan-Flagler Business

School. "Chapel Hill is an ideal environment for a family," says Mitchell. "You can live close to the B-school; the town is very family-oriented. And [then] when we got here, the families at the school completely embraced us."

Mitchell is one of a growing number of MBA students who head to campus with a spouse or a significant other—and, increasingly, a family—in tow. Unlike students in, say, medical and law schools, who usually attend just after graduating from college, most MBA candidates have

five years of work experience and enter business school at about 27 years old. Given that, the number of MBA students coming to campus with a family is topping 40% at some B-schools, up from 25% or less a decade ago.

While a single person who is giving up a full-time job and plunking down upwards of \$80,000 for two years of tuition—not to mention the cost of living expenses and lost salary—can easily devote endless hours to studying, adjusting to a new locale, and living the dorm life

for two years, MBA students with families face a far different set of challenges. Living without a paycheck and racking up debt when you've got kids and a spouse is hard enough. But family suffers when you're being a slave to an irregular class schedule, odd-hour study groups, extracurricular activities—from case competitions and consulting projects to a myriad of career-focused or community-oriented clubs—plus a time-consuming internship and job search. And, B-school administration



CHAPEL HILL, N.C.
A Friday Night Families dinner at UNC's Kenan-Flagler



a student worried about a partner's child's well-being doesn't get the most of the program. Family concerns have "played a greater role in the decision-making process for applicants in the last few years," says David Capodilupo, executive director of the MBA program at Massachusetts Institute of Technology's Sloan School of Business. Schools have moved to provide more programs and services to ease the transition—and the two years—before for everyone. Most boast a partners'

club that organizes events, socials, and support for spouses. Many schools offer job counseling for partners as well as a slew of activities for them and the kids that coincide with a student's orientation schedule. And some B-schools—helped by their students—have gone above and beyond to cater to family members.

The savviest schools anticipate the needs of partners from the first campus visit—before a prospective student has even been accepted. That was the case for Margaret Arthurs, whose husband, Ian, is a first-year MBA student at Dartmouth's Tuck School of Business. When the Arthurs arrived for Ian's campus tour and interview, the admissions staff invited Margaret along—a gesture the other schools didn't make. After her husband was accepted, Margaret got what the school calls a "smile-and-dial" call from a group of second-year partners offering to answer any questions she might have about the school. The Arthurs were already leaning toward Tuck, but the call confirmed what the couple believed—that Margaret would feel as welcome at the school as Ian would. When the Arthurs arrived on campus, Margaret took advantage of an uncommon perk among top schools: a marriage counselor who holds weekly sessions for spouses where they can hash out their adjustment problems and talk through the challenges of being a B-school partner.

Others, such as Columbia Business School, pay special attention to the families of international students, who often arrive not just in a new city but in a new country. While their spouse-students get

a built-in network of classmates and courses, the husbands and wives may find themselves without working papers and with minimal English-language skills. Early on, Columbia helps such families with housing and relocation. To ease the language barrier, the B-school offers free language classes through Berlitz.

THE DECIDING DETAIL

A FEW SCHOOLS GO out of their way to cater to children, too. Northwestern University's Kellogg School of Management is known as a place where students, faculty, and administrators are unusually close. Katie Bard, a mother of two girls under the age of 4, says Kellogg's brochure helped sell her—and her husband—on the idea of uprooting the family from Austin, Tex. "Of the five or six brochures we got from Top 10 schools, Kellogg's was the only one that featured photos of families," says Bard.

She adds that the reality lived up to the billing. At most schools, partners' clubs sponsor kids' activities, but at Kellogg children have their own club funded by the students' activities fee. Kellogg Kids holds twice-weekly play groups and offers a music class and a crafts class one afternoon each week. Parents trade babysitting duties, and Kellogg Kids even takes field trips to places like the zoo and holds bagel breakfasts for families and students. The club tries to lend extra support to international families; Bard, a past co-chair of Kellogg Kids, says about half the members are from outside the U.S.

Another twist on B-schools' nurturing of candidates' families: encouraging in-

The Welcome Mat

With an increasing number of MBA candidates heading to campus with a spouse and/or family in tow, most business schools have partner clubs. Some have gone out of their way to set up support systems and special programs.

B-SCHOOL	PARTNER PERKS
COLUMBIA	Pays special attention to partners of international students; offers language courses through Berlitz
DARTMOUTH (Tuck)	A marriage counselor holds weekly group sessions and is available for private meetings
NORTHWESTERN (Kellogg)	Kellogg Kids club is devoted entirely to activities for children of students; the school helps partners find work on campus
MICHIGAN (Ross)	Partners of admitted students go on a four-day preterm retreat; partners orientation mirrors students'
UNC-CHAPEL HILL (Kenan-Flagler)	An event called Friday Night Families brings students and families together with professors who have kids

Data: Business schools

teraction among children, partners, and students—and not just at holiday parties or special events. UNC student Craig Mitchell and his wife Wendy launched Friday Night Families at Kenan-Flagler, held two or three times per month. Kids get playtime with, say, crafts activities, and parent-students and their spouses

have an opportunity to mingle. The get-togethers allow married students to enjoy more of the social interaction that single students have always had. In the beginning, Friday Night Families was informal—a pot-luck dinner held at someone's house. Now the B-school's partner club provides some money to help pay for

the food and supplies for the gathering. Juggling the pressures of B-school make for a stressful two years for any student. Add a spouse, partner, or child, and it can be like juggling atop a wire. Finding a school that makes family experience as rich as the MBA program can make all the difference. ■

A Better Fit For Exec Ed

The companies that pay the tab are demanding more specialization. **BY LAUREN GARD**

ATTENDING A TRADITIONAL executive-education program typically means asking your employer to write a check for thousands of dollars, leaving behind family and colleagues for weeks at a time, and then studying everything from negotiation to marketing with attendees from a variety of unrelated industries. Now a new breed of exec-ed courses is cropping up to better serve managers in search of professional growth. These offerings are shorter and more tailored to the issues facing execs in specific industries.

The demand for more specialized fare

is coming from companies that foot the bill. If you're a boss at a pharmaceutical maker, for instance, would you rather spend \$23,000 on tuition to have your manager study innovation in the life sciences or take a generic course on innovation? The new classes may not be cheaper on a per-diem basis, but they aim to deliver a bigger bang for the buck.

"Plain vanilla really doesn't fit at all anymore," says Marie Eiter, director for executive education at Massachusetts Institute of Technology's Sloan School of Business. "The value used to be the cross-conversation where you got the aha!



[But] industries are becoming more competitive, and their issues differ."

That's why, after a plea from a biotechnology company that frequently sent employees to general courses but wanted more focused approach, MIT overhauled its Leading Innovative Enterprises program and customized the curriculum for execs in biotech, pharmaceuticals, medical devices. The program allows participants to dig deeper and engage in more robust conversations than in programs where attendees hail from different fields. "We were able to get into a very tailored, practical level of things we could actually do," says Bonnie Anderson, vice-president at medical-device maker Beckman Coulter, who has attended more traditional programs in the past. She recently went to the first of the reworked MIT program's three sessions.

One caveat: If you're seeking one of these more focused courses, you may have to be patient or hop on a plane. More B-schools can put together a top-notch general program than, say, one for Business for Lawyers, which the University of California at Berkeley's H

Executive Education's **New Look**

Programs at many B-schools are getting trimmed and tailored to address issues faced by managers in specific industries. Some examples:

B-SCHOOL	PROGRAM	DURATION	ATTEND IF:
UC BERKELEY (Haas)	Business for Lawyers	Three days	You need to learn more about how business operates
MIT (Sloan)	Leading Innovative Enterprises: Strategies for Growth	Three one-week sessions	You're a top-level manager in a life-sciences field—biotech, pharma, or medical devices
NORTHWESTERN (Kellogg)	Science for Managers	Four days	You supervise scientists but aren't always sure what they're talking about
WASHINGTON UNIVERSITY (Olin)	Olin Partners' Program	One day	You need a more focused business strategy or want to update your management skills

Data: Business schools



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School of Business will run in April. The three-day course, which aims to boost lawyers' ability to understand and converse with the business clients they represent, covers 10 topics, including marketing and entrepreneurship. And what other school would be as suited to host a weeklong program for wine-industry executives than the University of California at Davis Graduate School of Management?

In addition to creating industry-specific courses, schools are experimenting with more flexible ways of delivering standard management content. In January, Olin School of Business at Washington University

UC Davis offers a program for execs in the wine biz

in St. Louis launched a series of 15 one-day seminars after interviewing 60 companies about their executive needs. Each class tackles a different aspect of management and leadership, taught by the school's lead-

ing scholars in those fields. Olin Partners' Program lets companies buy seats to the seminars in bulk at increasingly steep discounts. One seat goes for \$695, while 100 cost just \$450 apiece. Their courses run about half the price charged by other top schools.

Back at the office, applying your new B-school smarts can be a challenge. In the past, schools have left that chore to attendees and their companies, but now they're trying to find ways to help. Northwestern University's Kellogg School of Management plans to offer a series of one-day courses to top-rung execs whose employees attend one of Kellogg's three- to five-day programs. "I kept hearing participants say: 'Gosh, I wish my boss could have heard some of that,'" says Stephen Burnett, Kellogg's associate dean for executive education. Rather than rehash what the others learned, a back-to-school session for bosses focuses on the view from the top—and how an employee's new skills can be put to use.

Leave it to business schools to come up with an income-producing product to teach executives how to manage people who have taken executive-education classes. But there's no value in sending employees off to sharpen their skills if their bosses don't know how to make the most of them. ■

The Break That Enriches

Columbia's executive head discusses how to pick a quickie course that's right for you. **BY LAUREN GARD**

B-SCHOOLS ARE OFFERING a wider array of executive-education courses, but figuring out which ones fit your needs can be a challenge. Ethan Hanabury, Columbia Business School's associate dean for executive education, talks with reporter Lauren Gard about making the right pick and how to get the most of your days away from the office. His first tip? Leave your cell phones and Blackberries behind.

Short courses lasting from a day to a week have been popping up. How are they different from the traditional, longer executive-ed programs?

The longer programs, which run one to four weeks, attempt to transform executives at a certain point in their careers. Most of these require some pretty intensive self-analysis and 360-degree feedback that challenge one's way of thinking.

Shorter programs are for executives looking to develop further expertise in an area. They're not looking to be transformed; they're not even looking to identify strongly with the school. They just need to know something about a specific topic. Short classes can also help refresh courses you've already had.

Any tips on selecting a course?

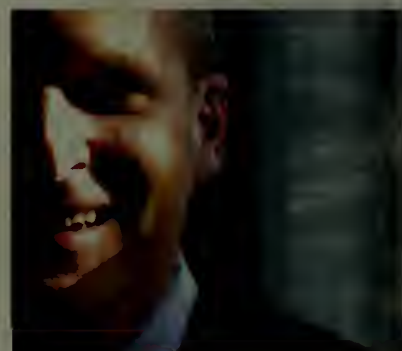
Get referrals. It's valuable to hear another person talk about what they took away from a course. It will help you decide and may also enable you to withstand the challenges you might get from others within your organization [regarding your time away from work].

How do you prepare for taking a short, targeted course?

Think about what questions you want answered and take an active role in the learning. Otherwise you might be in there passively, hearing what's going on but lacking focus.

What should you do to get the most of an executive education course?

Being open to the experience is the most important thing you can do. Clear the decks back home. Make



your boss and colleagues know that you're going to be away for a while and that you won't be responding to every e-mail. The whole idea is to step away from the urgent and look at the important. In the future, actually thinking of getting some of buy-in from bosses by having them sign something before employees come.

Also, ask specific questions. You're going to get more attention. Have dinner with a professor or a participant you think has an area of knowledge you like to explore. Be proactive in approaching people. ■

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& POOR'S**

The Robot Is In— And Ready to Operate

More and more surgeries—from prostate to heart—are being performed by doctors remotely guiding robotic arms. **BY CAROL MARIE CROPPER**

YOU WON'T SEE R2D2 wielding a scalpel, but robots are increasingly appearing alongside surgeons and nurses in operating rooms. At a cost of \$1.3 million each, a robotic system developed for the military and sold to private industry is helping doctors take out cancerous prostate glands, repair ailing hearts, even perform gastric bypass to help obese patients lose weight.

In such procedures, the surgeon's hands never enter the patient. After the initial incisions are made, robotic arms wielding a tiny camera and surgical tools make the snips, stanch the blood flow, and sew up inside when all is done. The surgeon sits at a console—usually in the operating room, although the technology would allow a doctor to operate on a patient on the other side of the world—peering into binocular-like lenses at views provided by the camera inside the patient. The doctor guides the robot's work by twisting his wrists in stirrup-like handles, moving his thumb and forefinger in scissor-like loops, or tapping foot pedals to focus the camera or move a robotic arm.

The most common robotic surgery is prostatectomy, or the removal of the prostate gland located just below the



bladder in men. But surgeons also use the system, called the da Vinci by its maker, Intuitive Surgical of Sunnyvale, Calif., for everything from heart surgery to gynecological and infertility operations. Its use has grown from just 1,500 procedures in 2000 to an estimated 20,000 last year.

Doctors who perform such surgery say they can see better because the smaller incisions mean less blood and the robot magnifies what's shown. They also say the robotic computer's ability to filter out routine hand tremors and scale down movements when tinier cuts are needed means more precision. Apart from smaller incisions and less blood loss, benefits

for patients include less pain and shorter recovery times.

An older form of minimally invasive surgery, laparoscopy, also uses miniaturized surgical instruments inserted through small incisions—although guided directly via long handles in the surgeon's hands—and comes with some of the same

advantages. But that method provides a two-dimensional view rather than the robotic system's 3-D vision and is harder for newcomers to master, says Dr. Vipul Patel, a Birmingham (Ala.) surgeon and a leader in robotic prostatectomies. With laparoscopy, there's no computer to adjust the size of the surgeon's movements or screen out tremors.

QUICKIE RECOVERIES

ROBOTIC TECHNOLOGY doesn't come cheap, which is one reason it's in fewer than 300 hospitals worldwide. But it might add, say, \$1,000 to the surgical cost of a prostatectomy, and \$4,000 to a heart mitral valve operation, total costs around \$24,000 (for a prostatectomy) and \$30,000 to \$40,000 (for the heart procedure) remain about the same because of savings from shorter hospital stays and less pain medication, according to surgeons who use the robot.

A Different Sort of **Sawbones**

Here is a list of the most common robotic operations, along with some of the leading hospitals and doctors in the field. For a complete list, go to businessweek.com/extras

PROSTATECTOMY

Henry Ford Hospital
Detroit
Dr. Mani Menon
City of Hope National Medical Center
Duarte, Calif.
Dr. Mark Kawachi,
Dr. Timothy Wilson

MITRAL VALVE REPAIR

Pitt County Memorial Hospital
Greenville, N.C.
Dr. Randolph Chitwood
St. Joseph's Hospital
Atlanta
Dr. Douglas Murphy

CORONARY ARTERY BYPASS

Alliance Hospital
Odessa, Tex. Dr. Sudhir Srivastava
Lenox Hill Hospital
New York
Dr. Valavanur Subramanian
Centennial Medical Center
Nashville, Tenn.
Dr. Louis Brunsting

more than 8,000 prostate
 ls were removed roboti-
 last year, up from 36 in
 . The procedure ac-
 cted for more than 10% of
 75,000 prostatectomies
 in 2004, says Intuitive
 cal. Surgeons who re-
 prostates robotically
 he method has advan-
 Undergoing open sur-
 may require a transfu-
 —which brings a risk,
 gh smaller than in the
 of blood-borne commu-
 le diseases such as HIV.
 professionals like the
 hat they can be out of the
 tal in a day, vs. two or
 for open surgery, and
 ne normal activities in
 week rather than six.
 tting nerves around the
 ate can lead to inconti-
 e or impotence, so preci-

is important. Between
 and 60% of convention-
 prostatectomy patients
 from impotence after-
 s, says Dr. Patel. Small
 es of robotic surgery
 shown at least a short-
 benefit in terms of im-
 ince and incontinence,
 Dr. Kevin R. Loughlin, a
 ssor of surgery at Har-
 Medical School. But, he
 the evidence remains
 conclusive.

. Lothaire Bluth, of
 rt, Ariz., opted for ro-
 s when he had his
 ate removed in 2003.

ad heard about incontinence and im-
 ince after prostate removal. A surgeon
 elf—albeit one who operates on
 —he knew how to research the op-
 . Bluth called hospitals and scoured
 nternet. In the end, he traveled to the
 ersity of California at Irvine Medical
 er to have his prostate taken out by a
 t. Bluth now has four barely visible
 to 1-inch scars rather than a 6- to 8-
 one. And, he says, neither inconti-
 e nor impotence is a problem.

eanwhile, heart surgeons are using
 ic technology to repair valves and
 ss arteries without opening rib
 s. A patient winds up with three or
 half-inch incisions instead of a
 d sternum and an 8- to 10-inch gash.

Scissors, Scalpel...**Robot**



1. ROBOT IN SCRUBS

An operating room technician drapes the da Vinci robot's three arms with sterile plastic in preparation for prostate surgery

2. GOING INSIDE

Dr. Vipul Patel (left) and his assistant, Rebecca Holmes, put the robot's arms through incisions the doctor made in the patient's abdomen

3. REMOTE CONTROL

Dr. Patel sits at a console 15 feet from the patient, directing the robot's movements as his assistants watch on a video monitor

That translates into less pain, blood loss, and trauma, says Dr. Michael Argenziano, director of robotic cardiac surgery at New York Presbyterian Hospital-Columbia University Medical Center. Hospital stays drop from five to seven days to two or three, and time away from work is cut from two months to about one, he says.

Not every patient is a candidate. Complicated cases—when the patient is very sick, needs multiple procedures, or has had previous chest surgery—are not suited to robotics, Argenziano says. Nor can a heart transplant or artificial heart implant be done this way.

Naysayers point out that a robotic operation done by a novice can take twice as long as open surgery. (Experts say be-

tween 20 and 50 operations are needed to become proficient.). If the unexpected happens, the patient may wind up being opened anyway. Then there's the fact that while the robotic camera may let the surgeon see better, he never feels the tissue he is cutting, which can be helpful in determining how far a cancer has spread.

So patients who want robotics' smaller scars and quicker recovery times will need to ask hard questions. Find out how many times the procedure you need has been done robotically and what the advantages and disadvantages are. Just as important, ask how many robotic surgeries the doctor who will do yours has performed. In real life, you want the force of experience to be with you. ■

EDITED BY TODDI GUTNER

HOTELS

ROAD WARRIOR WORKOUTS GET PERSONAL

IF RACING THROUGH airports and lifting luggage is not enough of a workout, travelers can tap certified personal trainers in major cities nationwide, thanks to a partnership between **Hilton Hotels & Resorts** and **Bally Total Fitness**. Hilton guests can now arrange for a personal trainer to meet them in the hotel's fitness room or at a nearby Bally's gym, at a cost of \$55 to \$70 per hour. Those who prefer exercising alone can ask the hotel for a "Travel Fit Kit"—yoga mat, hand weights, and elastic resistance bands—that will be delivered to their room for free. —*Kate Murphy*



BEVERAGES

Amazon Nectar

AMERICANS WHO VIEW Brazil as the land of samba and soccer may start to see it in another light—as an Eden of tropical beverages. Popping up at smoothie chains in ready-to-drink beverages is an Amazon-grown berry called açaí (pronounced Ah-sigh-EE) that some nutritionists value for its high antioxidant content. It tastes like a blend of chocolate and plum. You can find it mixed with other juices in bottled smoothies available nationally at Whole Foods under the **Sambazon** label (\$3-3.50 a 16-oz. bottle). A less diluted form of açaí is **Zola** (\$2.50 for an 11 oz. aseptic pack). Other Brazilian ingredients finding their way to beverages include guaraná, a caffeine-loaded berry, and acerola, a cherry-like fruit rich in vitamin C.

Coming on strong is coconut water, the liquid that brims out of freshly cut coconuts. It's a natural sports drink, low in calories but high in potassium, which is lost when you sweat. You can find it in vacuum-sealed packages under brand names such as **Zico**, available either in pure form or flavored with extras like passion fruit and orange peel. Zico runs about \$2 for an 11-oz. pack. —*Gerry Kherm*

HEALTH

IS CHOLESTEROL IN SEASON?

YOU KNOW SPRING IS HERE when the daffodils come up and your cholesterol starts to go down. In a study of 517 healthy subjects last year, researchers at the **University of Massachusetts Medical School at Worcester** found marked seasonal variations in lipid levels that were not explained by changes in diet or exercise. During the winter months, 22% of subjects reached levels at which doctors routinely advise cholesterol-lowering medication. The readings for those same subjects receded during the spring and were within the normal range in the summer. The findings suggest that some people may be taking cholesterol-lowering drugs needlessly. If you have no other cardiac risk factors, such as high blood pressure or diabetes, experts say treatment decisions should be based on the usually lower summer measurement.

—*Kate Murphy*

INVESTING

HOW DO EXECUTIVES invest their retirement funds? Cautiously, according to Clark Consulting, the largest administrator of deferred compensation programs. Clark examined how 17,000 execs with \$929 million in deferred comp plans allocated their money. Approximately **61% was in conservative choices**—fixed-rate investments, large-cap stocks, and fixed-income. Less than 18% was in foreign, specialty, and other "riskier" options.

Investment Option	% of Assets
FIXED-RATE	26
LARGE-CAP STOCKS	24
SMALL-CAP STOCKS	10
BONDS	9
MONEY-MARKET	6
COMPANY STOCK	5
MID-CAP STOCKS	5
FOREIGN	4
BALANCED	4
SPECIALTY	1
WORLD	1

*Does not add up to 100% because of rounding.
Data: Clark Consulting

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BY ROBERT BARKER

What Could Take a Bite Out of Whole Foods

I don't know about you, but I can't recall when I last saw two employees hugging in a supermarket. I don't mean a phony air-kiss-with-grazing-shoulders thing, but something more, um, full-bodied. The other morning, I witnessed two such hugs. Then, right as I was leaving, I saw a pair of shoppers actually making out.

This was no Winn-Dixie, but the Whole Foods Market in Winter Park, Fla., one of 167 locations run by the Austin (Tex.)-based grocer with a mission. All the lovin' left me feeling good. So did the '70s sounds (Carole King, Brothers Johnson) instead of Muzak; the meats, seafood, and produce (gorgeous berries; nine kinds of peppers); the helpful, smiling clerks; the choice of frozen pizzas (a 9.1-ounce American Flatbread All Natural Pizza Baked in a Primitive Wood-Fired Earthen Oven Organic Tomato and Three-Cheese pizza for \$6.79, or a Whole Foods' private label 16.5-ounce spinach and feta pie at \$3.69). Best of all was lunch: a big bowl of green split pea with soy bacon bits, one of six choices of soup at the deli, plus a mini baguette, for \$4.41.

YES, THERE'S A LOT to like at Whole Foods. So it leaves me feeling more of a killjoy than usual to suggest you think twice before buying the stock. This is not just because it's at record levels. The stock zoomed past 104, or 47 times past earnings, after the company posted 11.4% growth in its latest quarterly comparable-store sales. (Whole Foods is amending its results as it changes accounting for leases.) What really gives me pause is a fresh drag on earnings as Whole Foods strives to justify investors' lofty hopes.

Like other companies, Whole Foods this summer will be required by new accounting rules to deduct from earnings the costs of paying employees with stock or stock options. Unlike most other companies—especially unlike most other nontechnology companies—Whole Foods has been a heavy user of stock-based pay. Giving its 32,000 employees or, in Whole Foods-speak, its “team members,” a direct stake in the chain's profitability is a key to its guiding philosophy of serving customers, employees, and investors, in that order. This is clicking: Contented customers and employees have made ecstatic shareholders.



AUSTIN STORE

Options and stock grants will have to be deducted from company earnings

Now, however, the new accounting rules have prompted Whole Foods to begin rationing its awards of stock options so earnings eventually are dented no more than 10%. Whole Foods isn't saying how much this will cut

members' compensation. But we can guesstimate. In the four quarters, Whole Foods posted earnings of \$147.5 million (table). Had the costs of its stock-based pay been deducted from profits, earnings would have come to \$120.4 million more than 18% less. Had Whole Foods wanted to limit the earnings hit to 10%, it would have had to cut the value of option awards by perhaps 40% or 50%.

Whole Foods declined to discuss this with me, and it has yet to explain its plan to employees. It told Wall Street analysts that by accelerating the vesting of outstanding options—forcing a \$10 million extraordinary charge this year—and by paying team members a bit more in cash, it may soften the blow. After calling the accounting rule “stupid,” CEO John Mackey on Feb. 9 assured analysts that Whole Foods will be growing so fast, the drag on earnings will barely be felt.

That could happen. Or, if management does balance the hopes of its employees and Wall Street quite right, the team members whom Mackey credits with creating Whole Foods' success won't feel so rich. Then, some on the team might start whistling another of my '70s favorites, the Roberta Flack and Donny Hathaway duet, “Where Is the Love?” ■

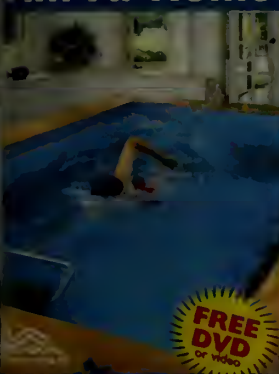
E-mail: rb@businessweek.com

Whole Story
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BY GENE G. MARCIAL

WHY STODGY DEERE COULD SUDDENLY GET A LOT HOTTER.

IMPAX LABS' GENERICS MAY CATCH THE EYE OF ISRAEL'S TEVA.

NEW, IMPROVED HANDHELD IMAGING GEAR FROM SONOSITE.

Plowing Cash into Deere

AN AVID OUTDOORSMAN who backpacks in the Utah mountains, 48-year-old Dave Young is called laid-back and easygoing by his friends. But as president and founder of investment firm Paragon Capital Management, there's nothing relaxed about his approach. "We're active, opportunistic—and against the conventional buy-and-hold investing style," he says. So Paragon stays just four weeks in most of its positions. "We expect to get rewarded within that time—and then get out," says Young. Since forming Paragon in January, 1998, his portfolio has gained 272%—compared with a 37% rise for the Standard & Poor's 500-stock index. The Paragon team eyes an array of data, including the ratio of growth to price-earnings, stock price to cash flow, stock repurchases, dividend yield, and "earnings surprises." Young monitors about 100 factors to pick up subtle shifts in the flow of

institutional money. Right now, he sees a shift to large-cap growth and value stocks—away from small-cap value stocks where he has been for 18 months. Deere (DE), the global No. 1 in farm machinery and also big in construction gear, is among Young's recent buys. He sees institutions snapping up Deere's stodgy stock, which has not moved much—although it is up from 62 in August to 71 on Mar. 2.

Young expects a jump in the next few weeks. In its first quarter, ended Jan. 31, Deere posted earnings of 89¢ a share—on an 18% jump in sales, to \$4.1 billion, up from 68¢ on \$3.4 billion a year ago. Andrew Casey of Prudential Equity Group, who rates Deere "accumulate" for the long term, expects earnings of \$6.10 in 2005 and \$6.75 in 2006, up from \$5.56 in 2004. His 12-month price target: 83 a share.

SPROUTING RIGHT UP



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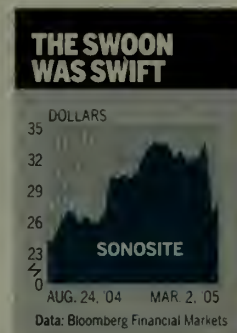
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The Allure of Impax

AS EXCITEMENT wanes from Novartis' buy of generic outfits Hexal and Eon Labs, who's next? The buzz says Impax Laboratories (IPXL), the generics use a controlled-release technology. "Impax' pipeline is impressive, so it's valuable as a stand-alone or buyout," says Robin Manners West of Mexico's State Investment Council, which owns shares. In November, its generic of depression drug Wellbutrin SR was approved. In January, its Ditropan XL for urinary incontinence got a tentative O.K. It has applications pending, with five tentatively approved. Who'll pursue Impax? Some say Israel's Teva Pharmaceutical Industries. Gregory Gilbert of Merrill Lynch, who has done banking for Teva, says a buy would put Teva on top in generics. West notes Impax and Teva work together on 12 generics. Impax, now at 17, is worth 26 in a bid, she says. Wachovia Securities' Michael Tong sees 2005 prices of 91¢ a share, vs. 2004's estimated 29¢. Teva declined comment. Impax did not return calls.



products for ultrasound imaging. With 60% of the portable market, SonoSite is No. 1. While GE is tops in big ultrasound gear, it has only 30% of the market in handhelds. Although SonoSite's handhelds are used by hospitals (70% of sales)—and in U.S. military hospitals in Iraq and Afghanistan—sales in 2005 are expected to total just \$144 million. It's a \$200 million market—but not for long, argues CEO Goodwin, who says a new hand-carried ultrasound will be launched in the spring. This device will match if not exceed the quality of big systems, beat them on price, and cut into their market, he says. When Goodwin told analysts in a recent conference call that SonoSite was spending a big share of its revenues on the new product, its stock swooned, from 33 in mid-February to 26 in two days. It has since inched up to 27.82 on Mar. 2. "The prospects for Sono's handhelds will greatly expand when the new machines come on the market," says Charles Reid, a partner at Brown Advisory, which currently holds a 7.7% stake. It will be the key, he adds, to driving up sales and fattening the operating margins. Reid sees the stock climbing to more than 50 in two years. Reid forecasts SonoSite earnings of 40¢ a share in 2005 and 80¢ or better in 2006, up from 27¢ in 2004. ■



SonoSite's Screen

HERE ARE FEW CEOs like Kevin Goodwin, who boasts that his company leaves General Electric in the dust. SonoSite (SONO) is way ahead of GE—in handheld

BusinessWeek online

Gene Marcial's Inside Wall Street is posted at businessweek.com/today.htm at 5 p.m. EST on the magazine's publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor their firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.

The S&P 500 in every share.

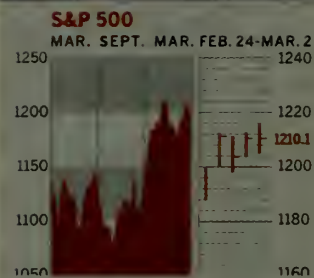
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Personal Business Figures of the Week

STOCKS



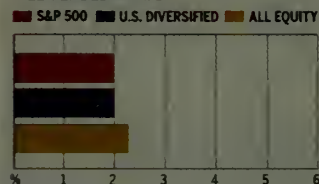
COMMENTARY

The Dow Jones industrials hit a 52-week high on Mar. 2 before retreating and ending the day in the red. The culprit was oil, which hit \$53 a barrel. Still, there was action beyond the oil patch: Analysts upgraded the chip sector, sending Intel and Texas Instruments higher. Caught between rising oil and falling bonds, equities appear stuck in a tight trading range.

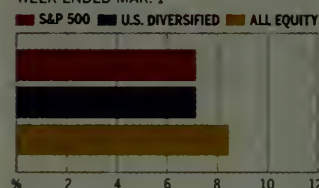
Data: Bloomberg Financial Markets, Reuters

MUTUAL FUNDS

4-WEEK TOTAL RETURN



52-WEEK TOTAL RETURN



Data: Standard & Poor's

U.S. MARKETS

	MAR. 2	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	1210.1	1.6	-0.2	5.3
Dow Jones Industrials	10,812.0	1.3	0.3	2.1
NASDAQ Composite	2067.5	1.8	-5.0	1.4
S&P MidCap 400	672.1	2.7	1.3	10.4
S&P SmallCap 600	332.1	3.0	1.0	15.9
DJ Wilshire 5000	11,924.6	1.8	-0.2	6.2

SECTORS

	MAR. 2	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
BusinessWeek 50*	728.1	2.1	3.3	14.5
BW Info Tech 100**	360.9	1.7	-3.3	0.5
S&P/BARRA Growth	583.0	1.8	0.2	2.5
S&P/BARRA Value	622.6	1.4	-0.5	8.2
S&P Energy	347.7	3.7	20.5	46.3
S&P Financials	400.3	0.8	-2.6	-0.4
S&P REIT	135.9	1.3	-5.9	9.2
S&P Transportation	227.3	1.0	-5.9	20.6
S&P Utilities	147.3	2.4	4.0	19.9
GSTI Internet	159.2	2.2	-10.7	14.6
PSE Technology	748.7	1.2	-3.9	2.5

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS

	MAR. 2	WEEK	% CHANGE YEAR TO DATE
S&P Euro Plus (U.S. Dollar)	1414.4	1.1	1.2
London (FT-SE 100)	4992.8	0.1	3.7
Paris (CAC 40)	4062.7	2.2	6.3
Frankfurt (DAX)	4393.4	1.9	3.2
Tokyo (NIKKEI 225)	11,813.7	2.7	2.8
Hong Kong (Hang Seng)	13,850.8	-0.8	-2.7
Toronto (S&P/TSX Composite)	9800.1	1.3	6.0
Mexico City (IPC)	13,770.3	1.7	6.6

FUNDAMENTALS

	MAR. 1	WEEK AGO
S&P 500 Dividend Yield	1.95%	1.99%
S&P 500 P/E Ratio (Trailing 12 mos.)	20.2	19.2
S&P 500 P/E Ratio (Next 12 mos.)*	16.4	16.0
First Call Earnings Revision*	0.56%	-0.02%

TECHNICAL INDICATORS

	MAR. 1	WEEK AGO
S&P 500 200-day average	1142.9	1140.2
Stocks above 200-day average	75.0%	70.0%
Options: Put/call ratio	0.66	0.73
Insiders: Vickers NYSE Sell/buy ratio	4.49	4.42

BEST-PERFORMING GROUPS

	LAST MONTH %	LAST 12 MONTHS %
Integrated Oil & Gas	15.0	72.9
Constr. & Engineering	14.8	72.7
Oil & Gas Refining	13.6	67.1
Steel	9.9	57.6
Oil & Gas Exploration	9.7	53.2
Divsfd. Metals & Mining	9.7	53.2

WORST-PERFORMING GROUPS

	LAST MONTH %	LAST 12 MONTHS %
Tires & Rubber	-10.4	IT Consulting
Internet Software	-9.3	Electric Mfg. Svcs.
Auto Parts & Equipment	-8.0	Insurance Brokers
IT Consulting	-6.3	Automobiles
Automobiles	-6.0	Semiconductor Equip.

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Natural Resources	10.2	Latin America	40.1
Latin America	9.5	Natural Resources	37.7
Diversified Emerg. Mkts.	7.5	Europe	21.9
Pacific/Asia ex-Japan	5.9	Diversified Emerg. Mkts.	21.6
LAGGARDS		LAGGARDS	
Health	-0.5	Technology	-6.1
Financial	-0.2	Health	-0.1
Large-cap Growth	1.1	Precious Metals	0.1
Technology	1.1	Large-cap Growth	2.9

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
ProFunds Oil & Gas Inv.	20.3	ProFunds Oil & Gas Inv.	70.6
U.S. Gbl. Invs. Gl. Rscs.	17.7	iShares MSCI Austria Idx.	58.4
ProFunds Semicdr. Inv.	14.4	BlackRock Gl. Res. Inv. A	57.4
Third Millennium Russia	12.9	Metzler/Pdn. Eur. Em. Mkt.	56.6
LAGGARDS		LAGGARDS	
American Heritage	-9.1	Ameritor Investment	-47.1
Fidelity Advr. Biotech. B	-9.1	Apex Mid Cap Growth	-32.2
Fidelity Select Biotech.	-8.8	ProFunds Semicdr. Inv.	-29.4
PIMCO RCM Biotechnology D	-8.7	Firsthand Tech. Innovators	-27.7

INTEREST RATES

KEY RATES

	MAR. 2	WEEK AGO
Money Market Funds	2.04%	2.01%
90-Day Treasury Bills	2.73	2.68
2-Year Treasury Notes	3.56	3.44
10-Year Treasury Notes	4.38	4.27
30-Year Treasury Bonds	4.74	4.66
30-Year Fixed Mortgage †	5.82	5.67

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
General Obligations	3.70%	
Taxable Equivalent	5.29	
Insured Revenue Bonds	3.71	
Taxable Equivalent	5.39	

THE WEEK AHEAD

INSTALLMENT CREDIT Monday, Mar. 7, 3 p.m. EST » During January consumers probably tacked on a further \$6.5 billion of new debt. That's the median estimate of economists surveyed by Action Economics. During December consumer credit increased by a modest \$3.1 billion.
BEIGE BOOK Wednesday, Mar. 9, 2 p.m. EST » The Federal Reserve will release its report on regional economic activity ahead

of the Mar. 22 monetary policy meeting. Economists expect another hike in interest rates, to 2.75%, up from 2.5%.

FEDERAL BUDGET Thursday, Mar. 10, 2 p.m. EST » The federal government probably ran up a \$100.5 billion deficit in February, after an \$8.7 billion surplus in January. On Feb. 7, the Office of Management & Budget issued its updated fiscal year 2005 budget estimates. The government

is now expected to post a \$426.6 billion deficit. A drop in projected income-tax revenue is an important reason for the upward revision.

INTERNATIONAL TRADE Friday, Mar. 11, 8:30 a.m. EST » The January foreign trade deficit probably stood at \$56.5 billion, following a December trade gap that narrowed to \$56.4 billion. Both exports and imports are expected to have increased a little during January.

The BusinessWeek production slipped to 237.1 for the week Feb. 19 but remained 11.5% above the previous-year level. In calculation of the four-week average, the index rose to 238.

BusinessWeek online

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/magazine/extn

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BusinessWeek (ISSN 0007-7135) Issue number 3924, published weekly, except for one week in January and one in August, by The McGraw-Hill Companies, Inc. Executive, Editorial, Circulation, and Advertising Offices: 1221 Avenue of the Americas, New York, N.Y. 10020. Periodicals postage paid at New York, N.Y., and at additional mailing offices. Canada Post Publication Mail Agreement Number 40012501. Return undeliverable Canadian addresses to: DPGM Ltd., 4960-2 Walker Road, Windsor ON N9A 6J3. Email: bwcustomerservice@neodata.com
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How Partisanship Puts Big Solutions Out of Reach

FOR NEARLY ALL of U.S. history, American political life has been sharply polarized. For two centuries deep ideological divisions have split U.S. society. Yet each era also bred advocates for pragmatism who pushed back against partisan extremism to seek common ground. By necessity, a frontier culture populated by immigrants who had to work together often chose practicality and common sense over dogma. America needs to make the same choice today in the battle over the tort system. It's only one of many fights being waged almost entirely in political rather than more practical terms. Social Security, Medicare, global warming, education—all critical issues—are debated with junk facts marshaled and marketed by one side or the other, with the best possible solutions all the more difficult to discern. Even universities—centers for research and learning—increasingly hew to a political correctness that refuses to respect ideas that veer from political orthodoxy.

America needs a nonpartisan space where numbers can be trusted, arguments can't be bought and sold, and all possible solutions and outcomes can be considered. That space doesn't exist in today's tort debate. There is little question that doctors and executives feel plagued by plaintiffs' lawyers who haul them into court again and again. Yet there are no reliable data showing that this amounts to a serious threat to the economy. The latest Bureau of Economic Analysis statistics show legal services accounting for less than 1.5% of gross domestic product, a lower share than in 1990. The "litigation tax" of \$246 billion that the anti-plaintiffs'-lawyer lobby says is imposed on the economy is in fact a number that includes everything from payouts for fender-benders to the salaries of insurance industry CEOs. It's a wild exaggeration. Meanwhile, with no real data available on medical-malpractice payouts, the Physician Insurers Assn. says the average size of those awards is \$350,000, while the Consumer Federation calculates it to be as low as \$30,000. Professors called as expert witnesses are often consultants to plaintiffs' lawyers or their organizations, while conservative institutes have their own experts on the payroll. Where are the facts?

And where are the facts in the debate over the Medicare drug benefit? Yes, many seniors complain about the high and

still-rising cost of drugs. But there are no numbers showing patients can't afford to buy them. Indeed, there are figures that indicate that most seniors are already covered by insurance or have sufficient income and assets to buy the medicines with no government help required. A plan that should have focused on the elderly poor became a huge middle-class benefit costing twice initial estimates and carrying unfunded liabilities three times that of Social Security. Why? The numbers used in the public discussion were politicized. AARP, the lobbying group for retirees, had the drug-expense issue. Drugmakers, which stood to gain financially from the bill, lobbied for it, too. And the GOP House and Congress obfuscated the real cost and funding liability figures. Is this the best way to forge public policy?

The same can be said for Social Security. There are many advantages to private accounts owned by individuals. But they have little to do with fixing Social Security's solvency problem. That would require lower benefits or higher taxes. And the very idea that Social Security even faces a crisis is

From tort reform to Medicare, answers lie in the "practical center"

supported by the numbers. If action is taken, retirees will get 73% of their benefits in 2052, according to the Congressional Budget Office. That's a problem, but it's not an emergency. Yet no one is listening. Liberals won't acknowledge that private accounts have any merit, and conservatives won't admit that Social Security needs only modest tinkering.

Today, Americans learn partisanship early. They observe a news media increasingly split between Right and Left. And students at many top Ivy League and state universities are educated by partisan faculties who see the world ideologically. Many professors teach a postmodern relativism, arguing that there are no objective facts, only what is seen through the lenses of class, gender, and power. No wonder twenty- and thirtysomethings seek an echo chamber of their own beliefs on blogs, Web 2.0, and TV. They're taught to distrust the possibility of common ground, a community of interests, and shared values.

Corporate America can ill afford this polarization. Offering support to partisans in Washington on social policy creates the risk of a strong backlash when power changes hands, inevitably does. Companies operate best in a pragmatic environment. And America operates best from the practical center. It is time to find our way back there. ■



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OUTSOURCING INNOVATION

SPECIAL REPORT First came manufacturing. Now companies are farming out R&D to cut costs and get new products to market faster. Are they going too far?

JOE ENGARDIO AND BRUCE EINHORN (P. 84)



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A close-up, low-angle shot of the front-left corner of a dark-colored Lexus LS. The image highlights the car's iconic spindle grille with the Lexus emblem, the multi-lens headlight, and the side mirror. The car is parked on a light-colored surface, and the background is a plain, light-colored wall.

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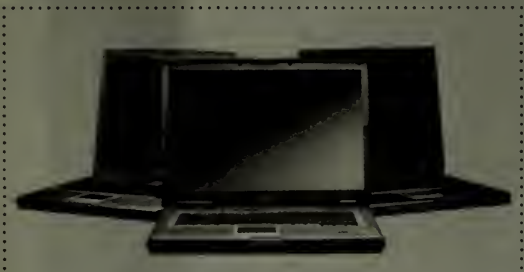
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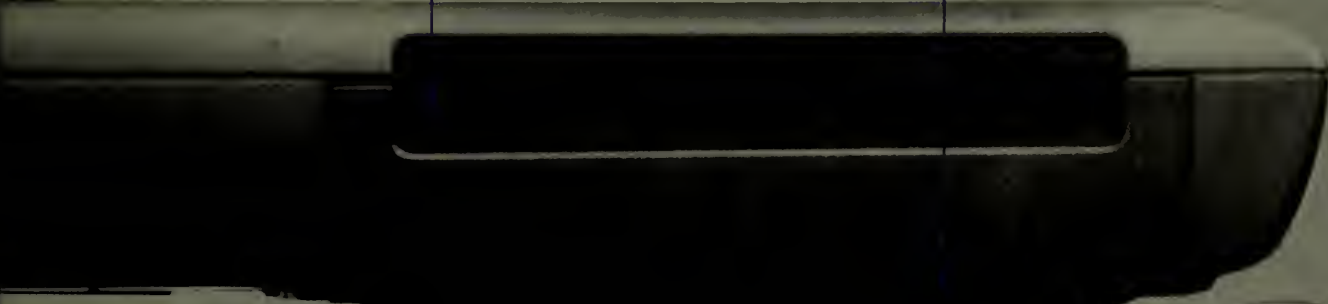


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Western companies used to pledge that their most important R&D would be kept in-house. Not anymore

Special Report

84 Outsourcing Innovation

It worked for manufacturing. Now big-name companies such as Dell, Motorola, and Philips are farming out their R&D to giant but little-known Asian developers. It's fast, it's efficient, and yes, it's cheaper. But the economic implications are enormous. Are these companies going too far?

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FRIDAY, AUGUST 29, 2003 ~ VOL. CCXLIII NO. 43 ~ ***** \$1.00

When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

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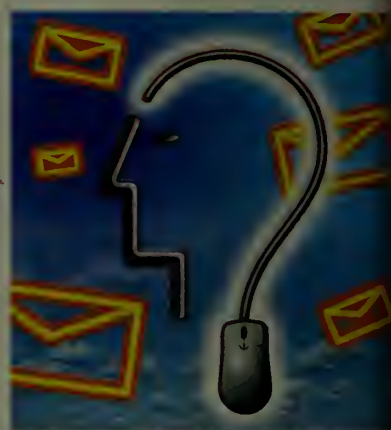
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You Have Technology Questions. Steve Wildstrom Has the Answers

One reader wanted to know if remote-access software used to connect to an office PC from home is vulnerable to viruses. Another asked about slow bootups for laptops. **BusinessWeek's Technology & You columnist** filled them in. Steve's new online-only **Help Desk** column is designed to help you get more out of your technology with straightforward and sound advice. Send your query to techandyou@businessweek.com



Navigating the Rising-Rate Landscape

Short-term interest rates are going up fast. PNC Bank's Tom Nis explains how small-business owners can deal with the current environment and why money-market accounts are in again

Vroom with a View at the Geneva Auto Show

The rubber hits the road to the future at the 2005 Geneva Salon International de l'Automobile. In an online slide show, BW correspondents take a look at the new models that made heads turn and jaws drop



The Rich Promise of the East

While the weak dollar has hurt some companies, analysts like the strong fundamentals and undervalued stocks in Asia's markets. With rising currencies and expanding economies, Singapore, Thailand, Indonesia, and the Philippines offer solid growth prospects

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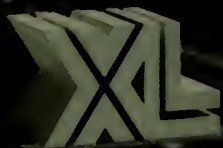
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"My hope was to make several multibillion-dollar acquisitions... but I struck out"

—Warren Buffett, in his annual letter to Berkshire Hathaway shareholders

ED BY IRA SAGER

PROFIT & GLOSS THE HAND THAT FEEDS YOU

IT **LIKES** those ubiquitous pop-up ads planted by invisible spyware? **Technology** **Investment** **Group** **Ventures** is betting big. The Silicon Valley venture-capital firm is helping to finance the anti-spyware company **Root Software**. It appears to be a bet that bet on a sizable investment in **Claria**, a company famed for spreading spyware. Claria has drawn criticism from legal action from media moguls such as **Dow Jones**, **New York Times**, and the **Washington Post**. They say the lately held Redwood City (Calif.) company, called **Gator**



until 2003, used pop-up ads to snare viewers from their Web sites. The suit was settled, and Claria no longer delivers pop-ups to those sites. But more than 40 million Web surfers viewed Claria ads last year. TCV has pumped at least \$13 million into Claria, but it has removed the company from a list of investments on its Web site.

Critics wonder why TCV would make dual investments. "Users are rubbed the wrong way by even the suggestion that the same companies that made this mess are now profiting from helping to clean it up," says **Harvard University** researcher and spyware expert Ben Edelman. TCV declined to comment. There is a similar element in both ventures: the potential to make money. —*Jessi Hempel*

CLARK In search of "principled leaders"



HALLS OF IVY

Rejecting the Hacker Class

MORE THAN 200 B-SCHOOL applicants have failed their first test in ethics by hacking into the files of **ApplyYourself**, a company that processes MBA applications. Several top B-Schools including **Harvard**, **MIT**, and **Carnegie Mellon** have decided to reject the hackers' applications. Using instructions anonymously posted on several Web sites, including at **BusinessWeek Online**, many of the hackers were able to view the status of their acceptance before letters were sent. **BusinessWeek Online** promptly removed the posting.

Harvard decided these potential students are not tomorrow's leaders. In a statement, Kim Clark, Harvard's dean, said the school wants to educate principled leaders with "a strong moral compass," adding that the hackers "failed to pass that test." So far, 119 Harvard Business School applicants and 32 at MIT's Sloan School of Business will get rejection letters.

Other schools are still assessing their stand. Stanford has asked the hackers to turn themselves in and will make admissions decisions on a case-by-case basis. Carnegie Mellon is trying to verify that two applicants hacked in—and will likely reject them. Hackers from **Duke** and **Dartmouth** have yet to learn their fate. Score one for ethics education.

—*Geoff Gloeckler*

THE BIG PICTURE

GLOBAL BUZZ Some brands carry more clout than others. Online magazine **Brandchannel.com** asked readers across the world to weigh in on the brands that stick. Here are their top 5:

APPLE

GOOGLE

NIKE

STARBUCKS

AL JAZEERA »



Brandchannel.com survey of 1,984 readers in 10 countries. Nov.-Dec. 2004. Parent company to Brandchannel.com. With **BusinessWeek** for an annual ranking of the 100 most valuable brands.

RETIREMENT STATES HAVE PENSION WOES, TOO

CORPORATIONS AREN'T the only employers with a big pension headache. State pension plans are in even worse shape, according to a soon-to-be released report by consultants **Wilshire Associates**.

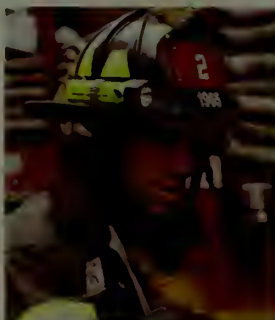
As of Dec. 31, Wilshire says the 109 state plans it tracks were \$375.6 billion underfunded, with 94% of them in the red. By contrast, the 331 companies in the S&P 500 that offer traditional defined-benefit pensions owed \$123 billion more to current employees and retirees than

their plans had in assets.

Even though states that have filed their 2004 reports show some improvement thanks to better stock market returns, many will need to up state funding or make risky new investments to meet their obligations. Some 90% of civil servants have traditional plans, says the **Labor Dept.**, vs. just 22% in the private sector.

While not all states are in a crisis, many of the largest are struggling. Illinois, which has a \$35 billion gap, owes an additional \$2.1 billion to meet minimum 2005 funding. And

in California, where Gov. Arnold Schwarzenegger recently called for a 401(k)-style plan for new hires to ease the state's financial burden, the debate is hot. —Nanette Byrnes



PRICEY? Civil servants



RETAIL DETAIL

ROYAL ZIRCONIA It took three decades for Prince Charles to seal his engagement to longtime mistress Camilla Parker-Bowles, with an eight-carat diamond-and-platinum ring that once belonged to the Queen Mother. But thanks to ASDA, the British discount store owned by Wal-Mart Stores, envious women won't have to wait long to pick up a copy of their own—at the bargain price of \$36. The sterling silver and three-carat cubic zirconia replica goes on sale at ASDA's 196 stores on Apr. 8, the day of the royal wedding. Those willing to come up with the more princely sum of \$57,000 can commission the store to create a three-carat diamond platinum copy. —Kerry Cape

AFTERSHOCKS MEASURING THE TSUNAMI'S WAKE

THE ECONOMIC damage from natural disasters rarely corresponds to death tolls. The tsunami that struck Southeast Asia on Dec. 26 killed an estimated 280,000. But economically, losses of \$14 billion in destroyed property were small compared to other disasters.

The spate of hurricanes that pummeled Florida and the Caribbean last year took fewer lives, says a report by insurer **Swiss Re**, but caused \$59 billion in damages. The difference? Poverty, which keeps Asia's property values low—but not its losses. —Jessi Hempel

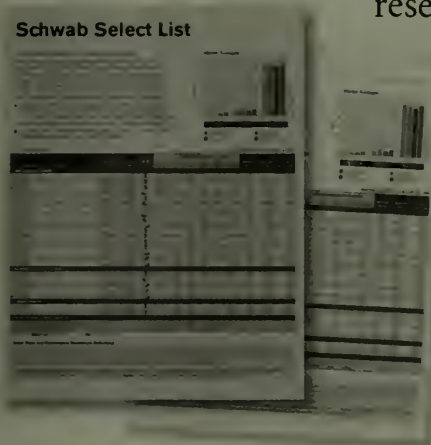
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FACE TIME

SCOTT FORD



THEY'D BETTER HAVE CALL WAITING

Scott Ford sounds just like the head of a rural telecom giant. The CEO of Little Rock-based ALLTEL has a Southern twang, likes to hunt and fish, and takes pride in providing local and wireless service to 12 million customers in 26 states.

He also sounds like an exec in a rapidly consolidating industry. ALLTEL's plan to spend \$4.4 billion for Western Wireless, announced in January, will make it even more appealing. Ford, 42, is open to a buyout. "If the economics dictate that we link up with a big provider, then so be it," he says.

Its country roots could make \$8.3 billion ALLTEL the belle at the telecom ball. Wireless giants Sprint and Nextel and veterans SBC and AT&T have inked megadeals, while Verizon, Qwest, and MCI are wrangling over their own. That leaves a dearth of candidates for companies such as BellSouth eager to plug holes in their rural coverage and keep pace with consolidation. Looks as if ALLTEL could have a leading role in the next round of telecom's musical chairs.

—Brian Grow

ECO TRENDS

CELL PHONES: EVEN MORE DEGRADING?

TIRED OF YOUR cell-phone cover? That's O.K. Just dig a hole and toss it in. Motorola is testing a biodegradable case that, when buried, disintegrates and sprouts sunflowers. The material, developed by **Pvaxx**, contains sunflower seeds. The Bermuda company expects to make its eco-friendly plastics commercially available within a year for cell-phone cases and other electronic gear.

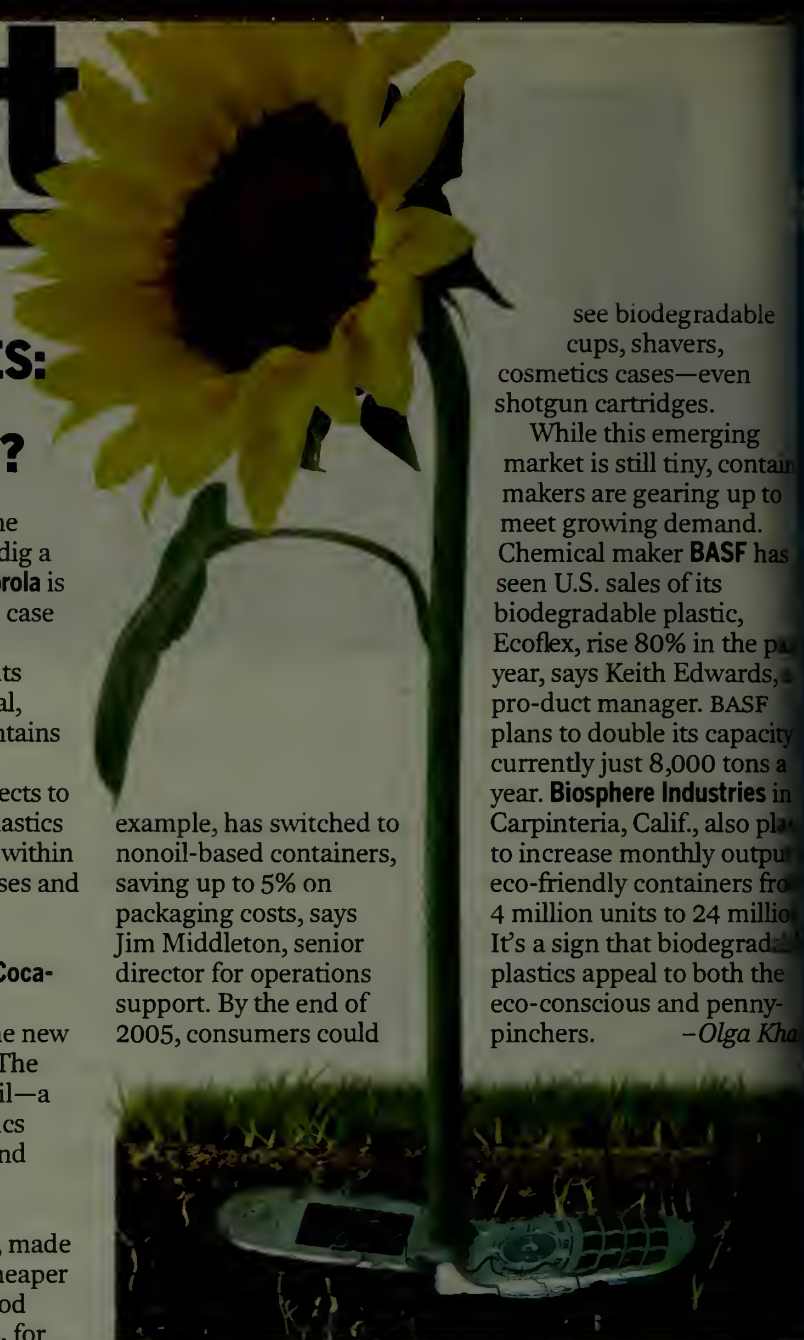
Motorola and other companies, including **Coca-Cola**, are testing these containers as part of the new economics of plastics. The skyrocketing price of oil—a key ingredient in plastics used for containers—and tough local landfill regulations have made biodegradable plastics, made of things like corn, a cheaper alternative. Organic-food seller **Wild Oats Markets**, for

example, has switched to nonoil-based containers, saving up to 5% on packaging costs, says Jim Middleton, senior director for operations support. By the end of 2005, consumers could

see biodegradable cups, shavers, cosmetics cases—even shotgun cartridges.

While this emerging market is still tiny, container makers are gearing up to meet growing demand. Chemical maker **BASF** has seen U.S. sales of its biodegradable plastic, **Ecoflex**, rise 80% in the past year, says Keith Edwards, a product manager. BASF plans to double its capacity currently just 8,000 tons a year. **Biosphere Industries** in Carpinteria, Calif., also plans to increase monthly output of eco-friendly containers from 4 million units to 24 million. It's a sign that biodegradable plastics appeal to both the eco-conscious and penny-pinchers.

—Olga Kha



NOTES ON COMP EXPATS, YOUR OPTIONS ARE GOING NATIVE

ATTENTION, overseas execs for U.S. multinationals: You may get fewer options. For many years, executives working for U.S. companies on foreign soil got the same option grants as those given to their stateside counterparts—even though local companies were far less generous. But with option expensing set to

start in June, many companies are cutting back by awarding expats smaller grants, in line with local practices.

A new study of 75 multinational corporations by consultancy **Towers Perrin** found that 39% of them either are trimming their overseas option grants or plan to soon.

U.S. companies clearly have room to maneuver. In Europe, the median option grant is 71% that in the U.S. In Asia, it is 60%. That foreign posting is looking less desirable every day.

—Louis Lavelle



THE STAT

20

The percentage of companies that have a workplace policy regulating dating coworkers. That's up from 7% in 2002.

Data: 2004 workplace survey of 234 companies by law firm Jackson Lewis

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Pharma caters to life. As ...the supply of new and innovative drugs declines, it will come at a cost to human health and lives."

—Jasjit S. Bindra
 Groton, Conn.



WHAT'S REALLY BEHIND PFIZER'S FUNK?

DESPITE EXTENSIVE research, Pfizer Inc. and the other drug companies have to realize that the industry is maturing and no longer capable of returning profit margins of 40% ("Pfizer's funk," Cover Story, Feb. 28). The stock market has already accepted the fact, as price-earnings ratios have been steadily declining for this segment. The reevaluation is reminiscent of chemical companies in the 1960s and 1970s. Despite large research expenditures, they became a mature industry with shrinking profit margins and lower p-e ratios. History is repeating itself.

—Nelson Marans
 Silver Spring, Md.

YOUR ANALYSIS of what happens when pharmaceutical blockbusters fizzle focuses only on economic consequences. What about the human cost? Unlike other industries, which are driven by product improvements catering to convenience and fashion, pharma caters to life.

Discovering and developing new drugs is getting more difficult and expensive. The low-hanging fruit has been plucked.

As the pipeline dries up and the supply of new and innovative drugs declines, it will come at a cost to human health and life. It's time to look for ways and regulations to support pharma—not strangle it.

—Jasjit S. Bindra
 Groton, Conn.

WHY S&P COMPANIES RAKED IT IN LAST YEAR

THE EXCELLENT article "A persistent profit machine" (Corporate Scoreboard, Feb. 28) reports that profits for U.S. corporations are up about 25% in the quarter of 2004, and there was a 14% increase in revenue from last year. The article fails to point out why U.S. corporations from the Standard & Poor's 500-stock index are doing so well.

U.S. multinationals produce about \$1 trillion of goods and services abroad about a quarter of U.S. gross domestic product. We observed a plunge in dollar last year against other major currencies, particularly the euro and yen. In 2004 the dollar declined 18%, and the greatest decline occurred in the 1st quarter. That translates into higher profits for U.S. multinationals produced abroad and repatriating their profits.

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BusinessWeek

MARCH 21, 2005 (ISSN 0007-7135) ***

3925

Published weekly, except for one week in January and one in August by The McGraw-Hill Companies, Inc. **FOUNDER:** James H. McGraw (1860-1948).

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Readers Report

CORRECTIONS & CLARIFICATIONS

Gene Marcial's "The allure of Impax" (Inside Wall Street, Mar. 14) should have clarified that Impax Laboratories was one of three companies that could make sense as possible acquisition targets in the generic industry, according to Merrill Lynch & Co.'s Gregory Gilbert. Also, the column should have noted that Gilbert's reference was based on a report he published and e-mailed to Marcial entitled "Generic M&A—Don't Get Carried Away," not an interview. The report stated separately that three companies, Barr, Ivax, and Impax could make "attractive acquisition targets," and in a separate bullet point that Teva "has historically been one of the more active acquirers in the sector."

the U.S. The greatest profits were reported in the last quarter of 2004, when the dollar was at a record low rate of \$1.37 to the euro.

Examining the profit scoreboard, one can observe that higher profits for companies relate to a high degree of multinational production.

—*Pellegrino Manfra*
New Rochelle, N.Y.

MICROSOFT'S NEW WEAPON IN THE GAME WARS

AS AN AMATEUR video game writer and player, I believe "Game wars" (Entertainment, Feb. 28) underestimates the growth potential for Microsoft Corp. The next-generation consoles for all three major game manufacturers are going to be based on the same type of IBM super-computer processor. Microsoft's next-gen software platform, called XNA, will cut video game production budgets by as much as 80% by having a standard operating code that is shared across the platform. As a game maker, you will be able to spend more time (and money) on the creative side of the job.

Also, the XNA platform will be shared across all next-gen Microsoft products, including the new version of Windows, Windows for cell phones, and Windows for next-gen PDAs. A game for one system will require that little, if any, modification be made for another system.

More than 20 major U.S. game developers, including Electronic Arts and Ubisoft, have been working with XNA for over the past year and a half, while not one major U.S. developer has announced it is working with Sony's new platform for their next-gen console. I think it's safe to say Microsoft will be a potential winner in

the video game industry, which is why I was sad to see it omitted from your list.

—*Carl A. Patrick*
Cincinnati

MEDICAID AND THE MIDDLE CLASS

IT IS OVERLY simplistic to blame Medicaid's problems on the legal shifting of savings by the middle class ("The new face of Medicaid," Government, Feb. 21). Financially helping one's children and grandchildren is not amoral; it is part of the fabric of our society and helps our economy through the spending and consumption of the younger generation. At an average cost of some \$9,600 per month for nursing-home care on Long Island, N.Y., even many of the so-called wealthy who end up in nursing homes will find themselves on Medicaid.

If the federal government redirected a more realistic portion of the taxes we already pay toward the high cost of nursing-home care or otherwise addressed the problem, perhaps the state and its counties would not now be facing such a financial burden.

—*Thomas J. Pellegrino*
New York

I HAVE BEEN practicing Medicaid law in California since the inception of the "spousal impoverishment" provisions in 1989. While many contend there is widespread abuse of the system, one glaring inconsistency in the law remains unaddressed. Those who try to care for their spouses at home are reduced to keeping a scant \$3,000 in assets (excluding the home) and \$934 in monthly income before they can qualify for Medicaid benefits. Meanwhile, those who send their spouses to skilled nursing facilities are permitted to keep \$95,100 in assets and \$2,378 in income. This forces seniors and the disabled into nursing homes rather than allowing them to remain in their homes.

—*Sara G. Senger*
McKinleyville, Calif.

"MOOCHING off Medicaid" (Editorials, Feb. 21) castigated middle-class seniors for shifting assets to relatives to qualify for government-paid long-term nursing care. There can be honest debate over whether the established rules on who qualifies for government-paid nursing home care should be changed. But no one should be accused of immorality for simply following the rules.

—*Ben Gumm*
North Berwick, Me.

LONG COMMUTES HAVE THEIR JOYS, TOO

I WOULD have gladly enumerated the advantages and pleasures of "Extreme commuting" (Working Life, Feb. 21). On a daily basis I drive, board a bus, do some walking, and then take two subway trips to reach my office at the southernmost tip of Manhattan. When I board the bus, I am on my "cruise ship," during which time I have the marvelous luxury of relaxing, reading, planning, etc. The subway gives me a precious insight into America, which I would never understand were I to remain behind the lavish shrubbery of my suburban milieu. I have met some marvelous people during my commute, one of whom, a corporate chairman, has become a treasured friend. The commute keeps me energized, enthusiastic, and informed. I do my subscription to *BusinessWeek*.

—*Evanne Geltzer*
Mountainside, N.J.

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Inside Enron's House of Cards

CONSPIRACY OF FOOLS A True Story
By Kurt Eichenwald; Broadway; 742pp; \$26

Even if you've read innumerable accounts of the Enron scandal, you'll find the meltdown depicted in Kurt Eichenwald's *Conspiracy of Fools* to be an eye-opener. His you-are-there narrative and fastidious attention to detail bring this byzantine saga to life as never before. Where else will you find yourself in ex-CEO Jeffrey

Skilling's bedroom as he struggles with the news of his best friend's suicide—or in then-Chairman Ken Lay's office as he prays over the phone with a bankruptcy lawyer who has just asked Lay to give up his job?

Eichenwald, a *New York Times* investigative reporter, can only hope that Enron ennui hasn't set in since the energy trader's collapse in 2001. Certainly, the basics of the story are well known, and they're replayed in these 742 pages: the convoluted, off-the-books entities concocted by crooked Chief Financial Officer Andrew Fastow, the seemingly willful blindness of the brilliant Skilling and confrontation-avoiding Lay, the multitude of bad, cash-guzzling international power projects masterminded by Skilling's nemesis, Rebecca Mark. The entire house of cards is propped up by the weak-kneed accountants at Arthur Andersen, not to mention a plethora of greedy lawyers and investment bankers and a clueless board of directors.

With a tale so laden with specifics that it's sometimes hard to follow the chronology, Eichenwald stitches together the many strands of Enron's undoing, from Houston to Washington and beyond. Appearances by the likes of George W. Bush, former Tyco International CEO L. Dennis Kozlowski, and ex-California Governor Gray Davis underscore the political, economic, and regulatory missteps that encourage Enron's deceptions. Through it all, Eichenwald somehow manages to give us fresh reasons for outrage. Consider Fastow's unbelievable chutzpah in demanding a secret, multimillion-dollar severance deal from Lay even as Fastow is being forced out. Or the realization by Enron's leaders during its final death spiral that none of the finance executives can track Enron's cash or know which debts are due when.

Like any exposé that purports to relay confidential conversations in boardrooms, bedrooms, and barrooms, Eichenwald's approach raises questions about the accuracy of his reconstructed dialogue. It's never clear who the sources are for any particular conversation, and Eichenwald warns readers not to assume that any individual participant in a conversation is even among the sources. But given the

author's apparent heavy reliance on documents, fleshed out with more than a thousand hours of interviews, he has likely come as close to reality as any outsider can get. It's abundantly clear why he's considered one of the best investigative reporters in the business.

What's also clear is the difficult task facing federal prosecutors as they bring Skilling and Lay to trial next year on charges of fraud and conspiracy. Skilling is shown pushing colleagues to minimize accounting losses, but he's never directly quoted ordering illegal behavior. When lawyers for the company learn of potential wrongdoing by energy traders in California, they don't tell Skilling for months. But the way he responds when he finds out is disturbing: There's no talk of further investigation or retribution for wrongdoers. Skilling just wants to be sure he can safely tell outsiders that "we're as pure as the driven snow."

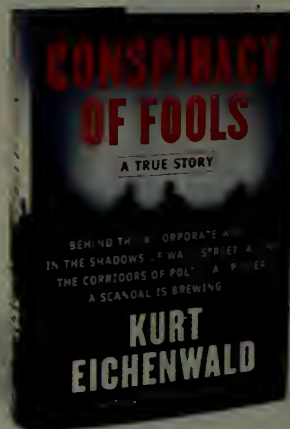
To many, Skilling's resignation as CEO in 2001 appeared to come out of the blue—and to be an obvious attempt to escape the blame for Enron's crimes. But long before, as Eichenwald makes clear, he suffered from periods of depression, bouts of drinking, and abrupt career moves. Like Skilling, consistently ignores warnings of serious problems. In 1987, for instance, he failed to prevent a trading scandal that nearly consumed the company, despite glaring red flags, including forged documents that are called to his attention. Still, he often seems clueless about the company's true financial state and continues to bet his fortune on Enron stock.

In a story where there are untarnished players, some guys stand out. Andersen accountant Carl Bass repeatedly battles colleagues to try to stop some outrageous accounting manipulations. Company risk analyst Vince Kaminski passionately points out to executives the stupidity of Fastow's schemes to hide losses. And Kaminski orders an

analysis of the possibility that the company may face a liquidity crisis long before it happens.

The Cassandra moment arrives when a midlevel analyst named Kevin Kindall determines that Fastow's off-books entities are filled with "trigger events" that could set off a downward spiral in Enron's stock price and lead to a lowering of its debt rating to junk status, an outcome Enron could not survive. Of course, Kindall's warning is ignored, and he quits the company. But thanks to Eichenwald, Kindall and other unsung heroes might finally get the attention they deserve.

—By Wendy Ze



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BY STEPHEN H. WILDSTROM

Like Having a VCR In Your Pocket

Your favorite basketball team plays in the NCAA tournament Friday evening, but you're going to be on a business trip across the country, where the match is unlikely to be broadcast. If you have a home PC that can record TV and a subscription to a new service called Orb, you could watch that game wherever you are via a laptop, Pocket PC, or even certain phones.

Streaming TV shows, as well as music and photos, to yourself from your home PC is still a very new idea. And the video experience you get will fall well short of even a mediocre TV set. The image will be small—maybe a 6-in. diagonal on a typical laptop, even tinier on a handheld. And network glitches may cause an occasional hiccup in the image. Still, this development is a clear indication of what today's consumer-electronics technology and wireless networks can provide. The first generation of recorders made it possible to shift the time when we watch. Now we can shift the place as well.

Orb Network's service, which costs \$10 a month or \$80 a year after a 30-day free trial, needs a PC equipped with a TV tuner and running Windows XP Media Center Edition. They're testing it on regular XP as well. The Orb software is fussy about just what TV tuners it works with—you'll need to check the compatibility list at www.orb.com.

YOU HAVE A LOT MORE FLEXIBILITY in the devices you use to watch programming. Any PC with either Windows Media Player or RealPlayer will work. So will any networked Pocket PC (Palm support is planned) or any wireless phone with Windows Media Player or RealPlayer.

To use Orb from a PC or handheld, you log in to a Web site that sets up a link to your PC back home. You can choose to view photos, your own videos, or hear music stored on your PC. But the real appeal is television—this setup lets you view recorded shows, select live shows from a channel guide, or schedule shows for recording. Click "play" and the show is delivered from your home PC to a handheld or computer.

The quality of the video you will see depends on a combination of display size and network speed; bigger images require



**Stream
recorded TV
shows from
home to a
remote device**

more data and need a faster link. Cingular's relatively slow network provided smooth video on the tiny screen of an Audiovox SMT5600 Smartphone. The video was worse on the bigger display of a Pocket PC on the same network and was all but unwatchable on a laptop. But both a laptop and a Dell Axim Pocket PC worked fine on a broadband connection via Wi-Fi. The system is designed so that the quality of the audio is maintained even as the quality of the video

degrades when network congestion reduces the available bandwidth. Still, I found that the player would occasionally pause both sound and picture while it refilled its buffer with data.

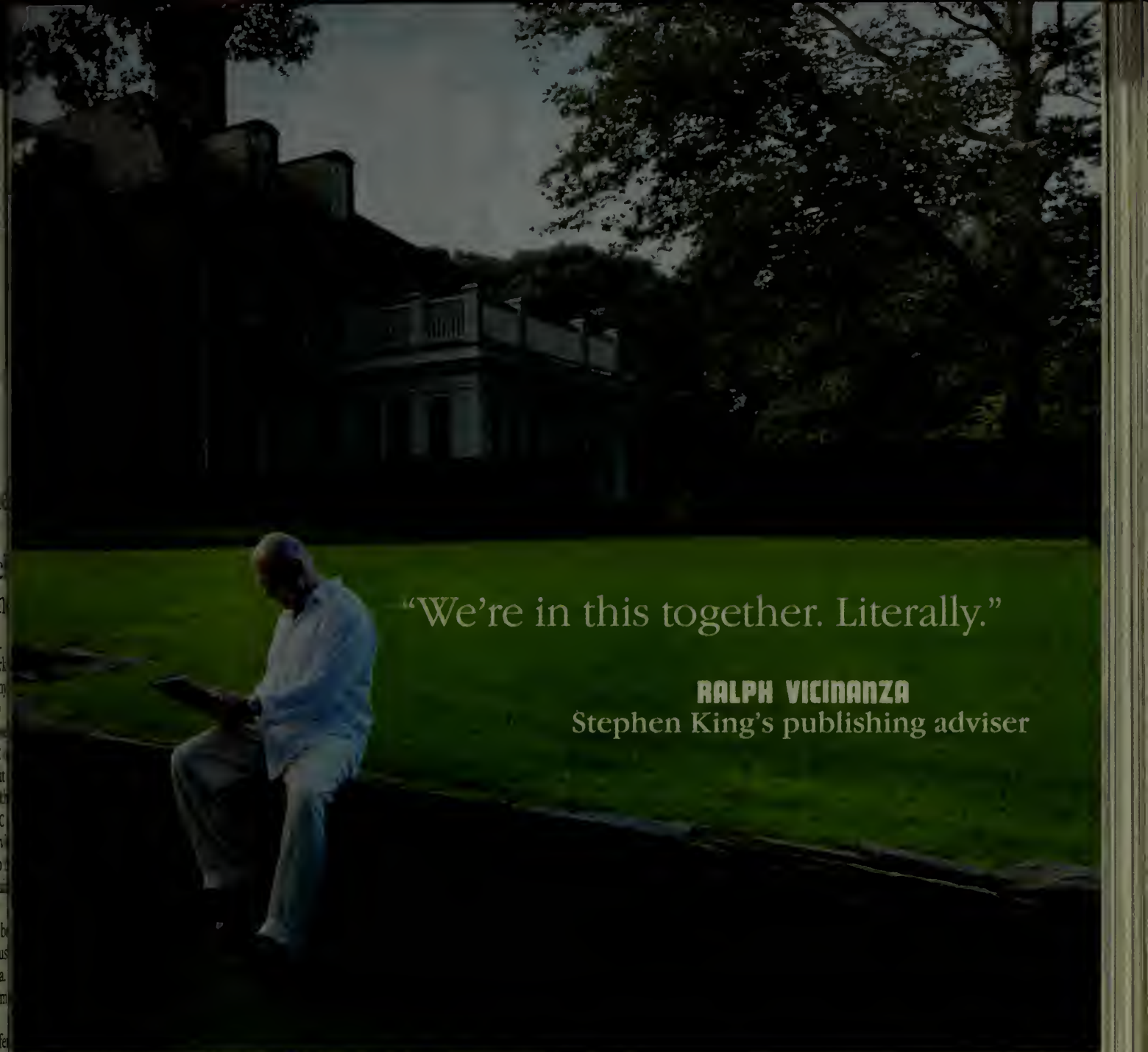
Orb can expect some competition later this spring from Sling Media, which is taking a different business and technical approach to the same problem. Rather than offering a PC-based service, Sling plans to sell a \$249 product called the Slingbox Personal Broadcaster that eliminates the need for a computer as part of your entertainment system. As with Orb, you connect to the Slingbox through a Web site. It sits in your entertainment rack, and can control a cable or satellite set-top box or a TiVo by acting like a remote control. You can then stream video to any Windows XP PC. (To record TV, you will need either a stand-alone digital video recorder or one built into a set-top box.)

For products such as Orb and Sling to reach their full potential, we need better networks. For example, a full-screen TV image requires moving at least 1.5 megabits per second. Most home DSL or cable connections limit upload speeds to well under 500 kilobits per second. Still, even today's limited speeds are enough to provide an intriguing glimpse of a future wherein you can watch the programming you subscribe to whenever you want, wherever you happen to be. ■

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BY GLENN HUBBARD

Social Security: Beware Of Hasty Compromises

Compromise is an important element of a lively policy debate. And reform of Social Security is topic No. 1 for domestic policy in Washington. President George W. Bush is saying that Social Security's unfunded liabilities are too large to ignore and that individually owned personal accounts offer an important path for America to save. The national conversation over Social

Security is already shifting to compromise, focusing on raising the cap on wages subject to the payroll tax and proposing "add-on" instead of "carved-out" personal accounts.

Raising the payroll tax cap is a bad idea. Proposals that suggest increasing the taxable wage base from \$90,000 to, say, \$150,000 would impose a 12.4% increase on the marginal tax rates of millions of Americans. These higher rates would offset the gains from President Bush's reductions in marginal income tax rates. A payroll tax hike would discourage work and entrepreneurship and would hamper job creation.

PAYROLL TAX INCREASES are unlikely to correct either the country's low savings rate or the need to shore up Social Security. An earlier tax increase—based on the recommendation of the 1983 Social Security Commission chaired by Alan Greenspan—raised the Social Security surplus, but those surpluses were not saved by Congress. The money was spent. Personal accounts offer a specific way in which Social Security contributions can be preserved.

The most compelling reason to avoid increasing the payroll tax is that the current structure of Social Security taxes and benefits is not a good deal for workers and retirees. Payroll taxes are high on young workers, and the promised benefits for older workers constitute essentially nonmarketable assets. Individually owned personal accounts are a better deal. Nearly 20 years ago, Kenneth L. Judd of Stanford University and I estimated that households might be willing to pay to opt out of these constraints of traditional Social Security. More recent research by economists Erik Hurst and Paul Willen of the University of Chicago quantifies that rational individuals would be willing to pay as much as 7.5% of their lifetime consumption to get out. That number is high because the constraints of the current system are painful and because Social Security is a major asset for many Americans.

Putting Social Security on a viable long-term financial footing could be better accomplished by slowing the rate of increases in Social Security benefits. Under the current system, initial Social Security benefits are indexed to average wage gains across the economy. A shift to price indexing would achieve financial soundness and reduce the system's unfunded liabilities by trillions of dollars. To ease the pain on lower-income

individuals, the burden of that adjustment in traditional benefits should be shifted to higher-income individuals who could use savings incentives, such as the President's proposed Retirement Savings Account, to save more for their retirement. Those savings could fund investment and growth.

Add-on accounts, however, should not be dismissed. If personal accounts alone were used to save Social Security, then one would clearly want to cut traditional benefits commensurately to compensate for them. But Social Security's fiscal problem is deeper than that. Benefits in the future must be increased more slowly than wages or the system's solvency cannot be restored. If we don't increase payroll taxes, solvency can be restored only by shifting from wage indexing to

something else, such as price indexing.

"Add-on" accounts are a good idea, but not higher payroll taxes

An add-on personal account can make sense. Tax-free add-ons would decrease government revenue in the near term, but the deficits could be modest, compared with the decrease in debt that would come from indexing benefits to inflation. The add-on personal account could be made more generous for lower-income workers as well, by the government matching individual contributions (much as the tax code

subsidizes retirement saving by higher-income taxpayers through individual retirement accounts or 401(k)s). Alternatively, the system's progressivity could be enhanced by increasing tax benefits for lower-income workers.

President Bush has started an important conversation by emphasizing personal accounts. It is possible to improve Social Security contributions to economic well-being by introducing personal accounts and decreasing the relative importance of traditional benefits for middle- and upper-income Americans. ■

Glenn Hubbard is dean of Columbia Business School. He chaired the Council of Economic Advisers from February, 2001 to March, 2003.

AMES C. COOPER & KATHLEEN MADIGAN

Job Creation Isn't a Problem, But Oil Might Be

Gas has hit \$2 a gallon—and the summer driving season hasn't even begun

U.S. ECONOMY For anyone who still felt a little uneasy about the health of the U.S. economy in early 2005, the government's report on the February job markets, which showed companies added 262,000 new workers last month, was the perfect elixir. The surprisingly strong gain in payrolls means that demand by both consumers and

businesses is on solid footing and that the economy in the second quarter may well be speeding up from the fourth quarter's 3.8% annual rate of growth.

But if you absolutely must have something to worry about, keep a close eye on the potential impact of the surge in oil prices on households and corporations in the second quarter. Last year about this time, a sharp jump in the cost of oil and gasoline took a big bite out of consumer spending and caused many businesses to cut back on their ordering and hiring.

The same effect on U.S. growth seems likely, given that the oil touched \$55 per barrel on Mar. 9, and analysts predict it will go higher amid few signs that world demand is moderating, especially in the oil-guzzling economies of China and India. Crude prices are already 45% higher than a year ago, and according to the Energy Information Administration, the national average for regular gasoline has already hit \$2 per gallon, up from about \$1.75 this time last year (chart). And that's before the demand surge that accompanies the spring and summer driving season.

How high can gas prices get? Given the historical relationship between the quarterly averages of crude and oil at \$53 per barrel implies gasoline retailing at about \$2.10 per gallon. If oil and gas prices follow last year's trajectory, then pump prices would hit about \$2.35 by the end of May, right as U.S. consumers begin their traditional driving season. If oil reaches \$60 per barrel, prices could near \$2.50.

It's important to note that fuel prices will still be less than those seen during the 1980 oil shock. Gas would have to cost \$3.50 a gallon today to equal the inflation-adjusted price of back then. But a higher energy tab could slow down demand and job growth. Policymakers at the Federal Reserve have taken notice. In a Mar. 8 speech, Governor Ben S. Bernanke listed a jump in oil prices as the wild card in his 2005 economic outlook.

LOOK AT WHAT HAPPENED last year. In the first half of 2004, the rise in oil prices diverted \$35 billion from other household spending and toward energy. And since that money went for higher prices, not for fuel, price-adjusted consumer spending slowed

sharply in the second quarter. Real outlays rose at an annual rate of just 1.6%, after surging by 4.1% in the first quarter. As demand drooped, businesses cut back on their hiring plans. Job growth averaged 223,000 in the first five months of 2004, only to slow to a 158,000 pace in the following five months.

This year, assuming oil prices don't spike to \$70 or \$80, the effects may be smaller.

First, the shock value of \$50 oil and \$2 gas has lost some of its oomph, and many consumers and companies have already adjusted their budgets to accommodate costlier energy. Since last July, oil has averaged \$48 per barrel and regular gasoline has averaged \$1.93 per gallon. Yet consumers in the second

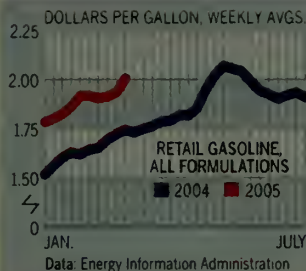
half of 2004 managed to increase their spending by the fastest two-quarter pace in nearly five years, and businesses boosted their outlays for new equipment at the fastest clip in more than seven years.

Second, the expansion is now well into its fourth year and even more firmly established. Businesses are more confident in the future and are going ahead with capital spending projects and hiring plans. Households are also more upbeat as job prospects brighten, and incomes are growing a bit faster.

THE STRONGER TONE of the labor market is the best sign around that both consumers and businesses will be up to this year's energy challenge. Companies are ready to expand their operations in terms of both capital and labor, and the additional income helps the household sector cope with costlier fuels.

In addition, the February jobs report confirms the message from other recent data on retail sales, factory orders, and business activity surveys: The economy retains a good head of steam in early 2005. Moreover, several labor-market indicators, especially the recent

GAS PRICES ARE RUNNING ABOVE 2004'S LEVELS



lurch downward in weekly unemployment claims, suggest another sizable advance in March payrolls should not be a surprise.

To be sure, some of last month's job jump reflected a bounceback from a modest January increase of only 132,000 jobs, a gain that was depressed for weather-related reasons. In particular, construction payrolls rebounded with a gain of 30,000, after no increase in January. Manufacturing jobs rose by 20,000, exactly reversing January's loss. And retailing posted a jump of 30,000 slots after a slim January gain. Altogether, January and February gains averaged 197,000 per month, a shade faster than the 190,000 per month average during the fourth quarter.

BEAR IN MIND THAT while energy is a hefty cost for many businesses, labor is still the biggest expense. And although hiring has picked up over the past year, companies appear to be managing that added cost with ease. Profit margins remain high, and expectations of earnings growth early this year may well be too low.

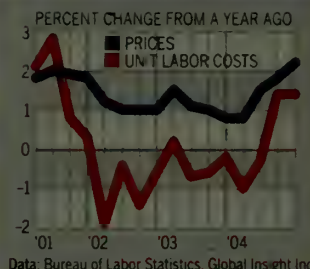
That's true even though productivity growth has slowed sharply during the past year, a trend that is putting upward pressure on unit labor costs. Output per hour worked in the fourth quarter grew at an annual rate of 2.1% from the third quarter, a sizable upward revision from the originally reported gain of 0.8%. But over the course of the year, productivity growth slowed to 2.8%, down from 5.5% during 2003.

Because hourly wages and benefits continued to grow

a bit more than 4% in 2004, the productivity slowdown means that unit labor costs ended the year by growing 1.4%, the fastest pace in more than three years. However, prices rose an even faster 2.2%, suggesting profit margins continued to expand from their year-ago levels (chart).

For 2005 the latest data show companies are still keeping a step ahead of rising costs. Pricing power appears to have picked up further in the first quarter. And hourly wages for production workers did not rise at all in February, indicating that unit labor costs are probably not accelerating in the first quarter. Fat margins will help businesses to absorb both rising labor costs and higher energy costs.

WHY PROFIT MARGINS REMAIN WIDE



The upshot: Profits are likely to come in much stronger the first half of 2005 than analysts now expect, especially the first quarter, given that analysts are currently looking for an advance of only about 7% from a year ago.

As with so much other recent data, the February employment report carried with it a positive surprise about the U.S. economy. Indeed, this expansion looks to have enough momentum that, barring further unexpected surges, even lofty oil prices shouldn't be able to knock it down. ■

EASTERN EUROPE

Searching for the Right Balance on Rates

A FLOOD of foreign money is lifting Eastern European currencies. In response, central banks in the region are cutting interest rates. But there are inflation risks to that strategy.

Investors have been flocking to the region because, except for those in the Czech Republic, central bank rates in Eastern Europe are at least a percentage point above the European Central Bank's. In addition, good productivity growth and low labor costs are attracting capital investment from abroad. Productivity at Hungarian factories rose 11.2% in 2004. As a result, the area's currencies have been surging (table). For instance, the Slovakian koruna hit a record high against the euro on Mar. 8.

So far, the currency runups have had a minimal impact on exports, a key part of economic growth. Czech exports were up 21% from a year ago in January. Productivity gains and limited wage pressures should help businesses maintain a large relative advantage over their euro-zone rivals. However, there is no consensus on how high the currencies can go before exports slow.

In response to the exchange rate surges, central banks are trimming rates and intervening in the currency markets. Only the National Bank of Poland has not cut rates, but a move is expected at the end of March after the NBP moved from a tightening

to an easing bias in February.

The challenge will be to balance the short-term desire to halt currency gains with a longer-run need to control inflation. Inflation is likely to slow sharply in the first half in part because stronger currencies are helping to lower the cost of imports. But cheaper borrowing could stoke demand and domestic price pressures. Plus, a big harvest in the region last year is currently keeping a lid on food prices. A repeat performance is unlikely.

Successfully navigating these financial and economic rapids will require patience. And it appears that central bankers are trying to avoid the past mistakes of moving rates too much and too fast. If the banks' policies prove successful, inflation and interest rates will end up lower with little harm to the region's economies. ■

—By James Mehring in New York

THE CURRENCIES KEEP CLIMBING

LOCAL CURRENCIES VERSUS:

	EURO	DOLLAR
CZECH REPUBLIC	11%	21%
HUNGARY	5	13
POLAND	23	32
SLOVAKIA	8	16

AS PERCENTAGE CHANGE FROM YEAR AGO

Data: Bloomberg Finance Markets



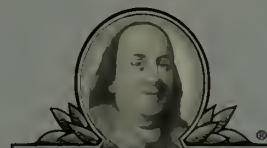
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Before investing in Franklin Flex Cap Growth Fund, you should carefully consider the fund's investment goals, risks, charges and expenses. You'll find this and other information in the fund's prospectus, which you can obtain from your financial advisor. Please read the prospectus carefully before investing. **Past performance does not guarantee future results.**

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Source: Lipper, Inc. as of 1/31/05. Lipper rankings do not include sales charges.

BWK3/05

EXECUTIVE SUITE

SONY'S SUDDEN SAMURAI

Four fixes that non-techie,
non-Japanese CEO Stringer
must make to rev up growth

IT WASN'T AS FAR-FETCHED AS, say, a geeky high school student morphing overnight into your web-spinning, friendly, neighborhood Spider-Man. But the Mar. 7 announcement that Sir Howard Stringer would take over management control of Sony Corp., a \$68 billion consumer-electronics and entertainment colossus, came pretty close to defying belief in Japan. Sure, Sony is a much-diminished force. But was it so desperate it needed to turn to a non-techie *gaijin*, a former CBS television news producer who speaks no Japanese and who plans to run the show mostly from New York, not Tokyo?

Outgoing Sony CEO and Chairman Nobuyuki Idei says he handpicked Stringer, 63, based on his undisputed success as head of Sony's U.S. music and film operations. It helped, no doubt, that he led a consortium to buy the fabled

Metro-Goldwyn Mayer Inc. studio for \$5 billion last fall, beating out Time Warner Inc. With Sony's operations so enmeshed in the U.S. and its brand so well known around the world, "there is no reason why management should be Japanese," Idei maintains.

But there's also no obvious reason Sony should remain the company it is. Stringer has to convince skeptical insiders and outside investors that its warring fiefdoms can finally be quelled and forced into a coherent company. If not, a growing pool of non-Japanese investors may simply insist on unlocking the value of Sony's parts through some sort of breakup. Insiders say a stock sale of Sony's Hollywood studio is already a live issue within the company. Stringer vows instead that, on his watch, Sony will finally achieve the long-promised magic of convergence between its disparate entertainment and con-

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4 Fear and loathing
in Boeing's exec suite

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anything risky at all?

38 Handicapping the race
to run Hewlett-Packard

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job market means



NOT LOST IN TRANSLATION

Stringer, who speaks
no Japanese, listens to
outgoing Chairman Idei (left)

sumer-electronics units. If this company were American and not Japanese, the board of directors would probably have forced a drastic solution a long time ago.

Can Sir Howard succeed where Idei so visibly failed? Look at the two sides of the balance sheet. On the negative side: Stringer lacks technical depth in electronics. He cannot possibly have a hands-on role in a thorny restructuring in Japan if, as planned, he remains in New York. Most troubling, the road map he is following is the one Sony has been presenting to the world for the past 10 years: to find the synergies among movies, music, games, and gadgets, including many that have yet to be invented.

But there are pluses as well. As a foreigner with much charismatic appeal, Stringer may be able to impose Western management practices that could radically reshape and revive Sony. "In a sense," he says, "it's easier for me as an outsider to execute, provided I find a way to enlist the support of the employees." He also plans to spend at least one week every month in Tokyo.

When he's there, Stringer will be working with some of the world's most creative hardware designers, robot maniacs, toysters, hackers, and other crackerjack nerds. Sony is still a design and innovation hot spot. "The problem is not an absence of great engineers or the absence of great ideas," says Stringer. What's more, the directors and their advisers—including internationalists such as Peter G. Peterson, senior-chairman of the private equity firm Blackstone Group, Nissan Motor CEO

Carlos Ghosn, and Yotaro Kobayashi, chairman of Fuji Xerox—are firmly behind the new CEO. "I happen to think Stringer is easily the best choice here," says Peterson.

Stringer calls the Sony brand "one of the 20th century's greatest creations." If it is going to survive in the 21st, here is what he must do—and quickly:

1 HALT THE SLIDE IN CONSUMER ELECTRONICS

In 2003, Idei set a goal to shave \$3.2 billion from Sony's cost structure, most of it from electronics, by eliminating 20,000 jobs, or 13% of the workforce, standardizing parts, and cutting the number of global suppliers from 4,700 to 1,000 by March, 2007. Sony is on target to hit that goal, but it's not enough: Sony's electronics division will probably lose \$288 million in the coming fiscal year ending Mar. 31. It's losing sales and profits to rivals about as fast as it cuts costs. And it is resorting to desperate discounting to hold market share. Last fall the company slashed prices on its liquid-crystal display (LCD) rear-view projection sets to undercut no-name Chinese brands.

Stringer has to lay off more workers, especially in high-cost Japan. Analysts estimate as many as 10,000 more jobs have to go. That will cost plenty: Severance deals in Japan often involve lump payments of 24 months. While Sony already sources plenty of electronic gizmos from factories in Asia, it will have to raise that ratio without allowing quality to suffer. The restructuring goals have to be announced quickly—before the summer—if

Stringer wants to sustain any credit. In doing so, he would be borrowing a page from the playbook of Carlos Ghosn, who announced clear cost-cutting targets shortly after taking over at Nissan. The new CEO must also make it clear that there are consequences for executives who fail to deliver. He seems to recognize that. "I cannot allow the generosity of Sony's [culture] to resist necessary changes," he says. "Kindness, in the end, can kill a company."

The good news: Stringer has experience. He whacked \$700 million a year of U.S. operations since 2001 and overhauled the studio operation by cutting producer deals and sharing costs on films. "It is a mistake to underestimate [him]," says MGM Chairman Alex Yemenidjian.

Nevertheless, much of the nasty work of restructuring electronics will have to be done remotely. Japanese deputies will have to wield the ax—and overcome Japan's entrenched culture of accommodation and face-saving. Right now, the man role seems to fall to Executive Deputy President Ryoji Chubachi, who Idei has described as a good listener and consensus builder. The next 12 months will test his mettle.

2 COME UP WITH SOME NEW HITS—LIKE YESTERDAY

Sony is already making some of the right moves in cranking out novel products that consumers want. It's reaching out to other companies to share the burden of developing new technol-

Dysfunctional Empire: **Sony** at a Glance

Although the Sony brand is still strong, the far-flung operations of this \$72 billion company have resisted cooperation, and the floundering hardware business, once the heart of the enterprise, is dragging down earnings. Here's what Stringer has to work with:

ELECTRONICS



MUSIC PLAYER

OPERATING LOSS: \$288 MILLION*

With \$50 billion in sales but few hits to its name, it's Headache No. 1. Sony is still too focused on

outdated cathode-ray-tube TVs. Video cameras are weaker than they should be. And its MP3 player doesn't hold a candle to the iPod. The high costs of Japanese manufacturing and a not-invented-here syndrome have also hurt.

MUSIC

OPERATING PROFIT: \$145 MILLION*

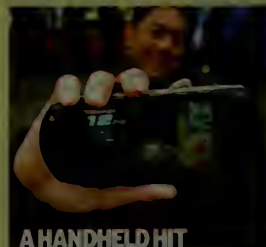
Stringer's big restructuring play: By merging Sony Music with BMG, he got economies of scale in a mature industry. Alicia Keys helped, too, as did a good run of Japanese pop stars and old



ALICIA KEYS

reliables such as Springsteen and Dylan. But will the gains from the merger continue as the music business keeps eroding?

GAMES



A HANDHELD HIT

OPERATING \$385 MILLION*

PlayStation remains sort of. The new handheld PlayStation is a hit in Japan, promises to succeed in U.S. gamehead PlayStation P

is also billed as the breakthrough in digital convergence: Buyers can download movie music, and more. But ramp-up costs for the handheld will pull operating profits down 4 and Microsoft's Xbox is hungry to take sha-



d in at least a few cases it's staying ahead of the pack. One example is a stable version of the PlayStation, which is the U.S. market this month, and the next generation console, PlayStation3. The game machine will run on a superfast chip called Cell, which Sony developed in a partnership with Toshiba Corp. and IBM. Sony Ericsson Mobile Communications, a joint venture in cell phones, has gotten its way back into the handset game. Sony backed a joint venture with archrival Samsung last year to manufacture high-end LCD panels for flat televisions. And Sony has fielded a plausible bid to dominate the next generation of high-definition DVDs, with its Blu-ray format. In its camp: Samsung, Panasonic, Dell, and Disney. Partnerships speed up product development. But Stringer still has to banish some

old-fashioned thinking, like trying to control the market with proprietary technology. When the company launched its answer to Apple Computer's iPod, Sony made it impossible for customers to play songs in formats other than its own. Now the world of online video is emerging, and once again Sony seems stuck in the same groove again. Its solution for sharing video among multiple devices is an approach called Giga Pocket that appears to work well only with Sony gear. Two years down the road, video could be bigger than music, and Sony could be a major player. But it needs to throw its full weight behind industry standards and depend on the excellence of its products—rather than lock-in—to win consumers.

Finally, Sony should do less to achieve more. Of the hundreds of different products Sony factories exhale each month, only a handful are real profit makers. As Stringer puts it, "Sony is battling on a very broad front.... [We] are going to have to look at the balance sheet to see if there are too many winners and losers."

3 CRUSH THE SILOS INSIDE SONY

There's no doubt Sony has the most enthralling assets of any entertainment company. But even Sir Howard admits that Sony needs "better integration between our services and our device portfolio." Translation: Studio execs and hardware geeks don't talk.

Stringer has to set up a framework

where executives around the world from games, music, movies, and hardware meet often, hatch plans, set goals, and—if they fall behind—take responsibility. If that means planting cosseted Hollywood execs in stiff, white-collar environments in Tokyo for six months at a stretch, so be it. If senior staff can't meet these requirements, Sony shouldn't be the right home for them.

Breaking the silos is probably the hardest task Stringer faces. The Sony factions are as wily as they come. Back in 2002, Idei and other senior executives came up with the sensible idea of selling off its Sony Life insurance division to General Electric Co. It was profitable but made little sense for a consumer-electronics giant. There was just one catch: Sony Life execs rebelled, leaked nasty stories to the Japanese press about Idei, and forced Sony to cave.

Stringer thinks the ammunition is in place to blow up some silos. Phil Wiser, Sony's chief technology officer in North America, is deep inside the inner circle of engineers in Tokyo. And, Stringer adds, "there's no longer resistance to content people participating in everything." The Welshman has pushed hard to break down resistance inside U.S. operations, especially between the movie studio and the games and electronics divisions. "Howard is pretty insistent about supporting the other parts of the company," says Michael Lynton, Sony Pictures Entertainment chairman. Stringer's lieutenants are now looking forward to such connections with Japan. "Tokyo is now Howard, so I think we'll see ever more co-operation between music and electronics," says Andrew Lack, CEO of Sony BMG Entertainment.

A key silo issue is the role of Ken Kutaragi, the official Sony bad boy. Kutaragi created the PlayStation in 1994 and has run the game unit ever since. His gang delivered an astounding 68% of Sony's \$650 million in operating profits last year. In the recent power shift, he was knocked off the board. With his brash manner, "Ken doesn't have a lot of friends in the home office," says one insider. But Stringer should rise above that and find a suitable cross-boundary role for one of Sony's most creative dynamos.

ES

ING PROFIT: \$528 MILLION*

Boffo. *Spider-Man 2* wiped out the dud effect of 2003's super-bomb *Gigli*. Will Smith's *Hitch* is a nice hit. But the big assets are the tight cost controls and a shrewdly managed acquisition of MGM's film library. Clouds on the horizon: No surefire blockbuster for 2005, although sci-fi thriller *Stealth* may pay off.

ynch, BW *Merrill's estimates for the fiscal year ending in March

4 THINK THE UNTHINKABLE

What if Stringer fails to tease out the synergies that would elevate Sony—and what if Sony's notorious factions defy his efforts? As Stringer himself concedes, "the worst nightmare would be passive resistance."

If it happens, the chief should go to the next step and plan an orderly breakup of the company. A stock offering of the studio would be snapped up, considering the good job Stringer's lieutenants have done

in containing costs and producing hits like *Spider-Man*. Games could be a stand-alone company. And if electronics went out on its own, management could focus on cutting costs and rolling out new products. Silicon Valley has murmured that parts of Sony would fit nicely with Apple.

A bust-up, of course, is the last thing on the mind of Sony's rank and file. "We've been blasted the last couple of years for not having a Michael Dell in charge," as one Sony insider puts it. "Here is the face and

voice of a powerful figure running a successful company." It's certainly the most audacious management call in Sony's year run. If Stringer can't reboot Sony at this point, it is hard to think who could.

—By Brian Bremner in Tokyo

Cliff Edwards in San Mateo,

Ronald Grover in Los Angeles, and

Lowry and Emily Thornton in New

BusinessWeek online For a Q&A with Howard Stringer go to www.businessweek.com/ex



PANASONIC TVS
Matsushita sales are climbing

TURNAROUNDS

Lessons From Matsushita's Playbook

If new Sony Corp. boss Howard Stringer wants a few tips on how to turn around an ailing Japanese electronics giant, he might do well to hop on the Shinkansen bullet train to Osaka for a chat with Kunio Nakamura. He's the mastermind behind a turnaround at Sony's archrival, Matsushita Electric Industrial Co., the maker of Panasonic-branded TVs, stereos, and DVD players.

Three years ago, Matsushita's uninspired products had lost their luster with analysts and consumers alike. The result was a \$3.6 billion loss in the year ended March, 2002. Now those dark times are fast becoming a distant memory. Operating profits for the current fiscal year are expected to jump more than 50%, to \$2.9 billion, as sales climb 17%, to \$83.4 billion. Today the rejuvenated Matsushita, the world's biggest consumer-electronics maker, is also one of the most successful. Nakamura aims to boost operating margins to 5% by March, 2007, up from 3.4% today. While still well behind the double-digit margins of Korean

rival Samsung, that probably would have had Sony's outgoing chairman and CEO, Nobuyuki Idei, doing cartwheels in the executive suite.

Nakamura's secret: the kind of extensive cost-cutting few executives—other than Nissan Motor Co. boss Carlos Ghosn, perhaps—thought possible in Japan. While Sony dithered, Nakamura shaved billions of dollars from Matsushita's cost base by slashing its domestic workforce by 19% since 2001, to 112,000, and closing 30 factories. While Matsushita has invested in factories overseas, it has also boosted productivity at home. "The sense of shock changed the mindset of the remaining workforce," says Yuki Sugi, an analyst at Lehman Brothers Inc. in Tokyo. And the 65-year-old Nakamura shows few signs of

letting up: In January, Matsushita announced plans to trim \$1.15 billion more from costs over the next two years.

Cost-cutting, though, tells only half the story. While Sony often missed the boat on technologies and products—flat-screen TVs and digital music players leap to mind—Nakamura supplemented cutbacks with an increase in research and development spending and a renewed focus on creating innovative goods. Unlike Sony, where each business unit often decided on its own products, Matsushita senior managers have to sign off on new offerings. The results have been remarkable. In digital cameras, where Matsushita was nowhere just a couple of years ago, Panasonic's slim, 4-megapixel Lumix DMC-FX7 was the best-selling camera in Japan in the fourth quarter. Meanwhile, Panasonic made an early push into DVD recorders, giving it more than 30% of the Japanese market. In plasma TVs, Panasonic has 40% share in Japan. "Matsushita is better at introducing the right technologies at the right time," says Koya Tabata, an analyst at Credit Suisse First Boston Securities in Tokyo.

Sir Howard might also pick up a few management tips from Nakamura-san. Although he's known for being soft-spoken and polite to a fault, Nakamura is also quick to make tough decisions. And while Idei struggled to tame the rivalries among Sony's various units, there's no question about who calls the shots at Matsushita. "All the senior managers are fully aware of their responsibilities," says Masahiro Ono, an analyst at Morgan Stanley in Tokyo.

Perhaps more than anything, Matsushita's turnaround shows that Sony, while wounded, shouldn't be discounted. As Nakamura knows well, with the right strategy and management, even stumbling giants can regain their footing.

—By Ian Rowley, with Hiroko Tashiro, in Tokyo

Reversal of Fortunes

33%

Increase in Matsushita's shares since Jan. 1, 2003

-15%

Change in Sony's shares since Jan. 1, 2003

Data: Bloomberg Financial Markets

CHESTER DAWSON

The Wild, Wild East

Japanese companies are benefiting from a dose of Western capitalism

HOWARD STRINGER, Sony Corp.'s newly appointed chief, is the latest member of one of the world's most exclusive clubs: foreigners running Japanese companies. This group—the Japanese call them “blue-eyed” CEOs—includes Carlos Ghosn at Nissan Motor Co., incoming Shinsei Bank head Thierry Porte, and former Mazda Motor President Mark

But don't expect this tiny club to grow much bigger anytime soon. Japan remains a place where outsiders are viewed warily. Just because the club is unlikely to expand, though, doesn't mean that the management practices its members espouse won't spread. After the wrenching contraction of the 1990s, the country is more open than ever to “Western-style” capitalism. Many execs who once sought to capture market share and revenue at the expense of profits are finally embracing shareholder-friendly yardsticks such as high profit margins and low debt ratios. Goldman Sachs estimates average return on equity at Japanese companies will be 10% this year, the highest since 1989 and up from zero in 2001. “There's a big switch taking place in Japan,” says Charles B. Rosenwald III, chairman and managing partner of Los Angeles-based hedge fund Dalton Investments. “Concepts like ‘return on capital’ have become much more widespread.”

Stringer will benefit from the precedent set by the likes of Carlos Ghosn, who was the first foreign exec to lower the price of Nissan. Once vilified for shuttering three factories and cutting thousands of jobs, Ghosn is now hailed as the savior of an auto maker that faced bankruptcy in 1999. He did that by setting ambitious cost-cutting and earnings targets and then implementing them, sometimes ruthlessly. The result of that toughness: Nissan enjoys a profit margin at the top of its peer group. Nissan's revival has spurred others to emulate Ghosn's techniques. Even archrival Toyota Motor Corp. instituted a cost-cut-

ting plan under Katsuaki Watanabe—the exec set to take over as president in June—to match the austerity at Nissan. One result: Toyota has raised its operating profit margin from 2% in 1993 to just shy of 10% today. Canon Inc. is another company that has avoided the low profits and high debt loads that have been a hallmark of Japan Inc. That's the work of hard-charging President Fujio Mitarai, who credits his experience heading Canon's U.S. business in the 1980s for his earnings-oriented approach. “The lesson of the 1990s for Japanese firms is that they have to focus on profit growth to survive,” says Hugh Patrick, a Japan expert at Columbia University.

At the same time, Japanese managers who don't share the twin goals of maximizing profits and selling off underutilized assets are coming under increasing pressure, both from longtime insti-

tutional shareholders and newer players. Japanese buyout boutiques and foreign hedge funds have noted that more than a third of the companies on the Tokyo Stock Exchange trade below the book value of their assets—and are snapping up shares and pushing for change. In 2003, Tokyo-based activist fund M&A Consulting Inc. won the support of Japan's Pension Fund Assn. in an ultimately unsuccessful bid to force women's apparel maker Tokyo Style to dole out its \$1 billion in cash reserves by hiking dividends.

Fortunately for investors, that was just an opening salvo. Steel Partners Japan Strategies LP, an American private-equity fund, forced Yushiro Chemical Industry Co. to more than triple its 2004 dividend by tapping its cash hoard. And in January, Teikoku Hormone Manufacturing Co. said it would nearly double its dividend

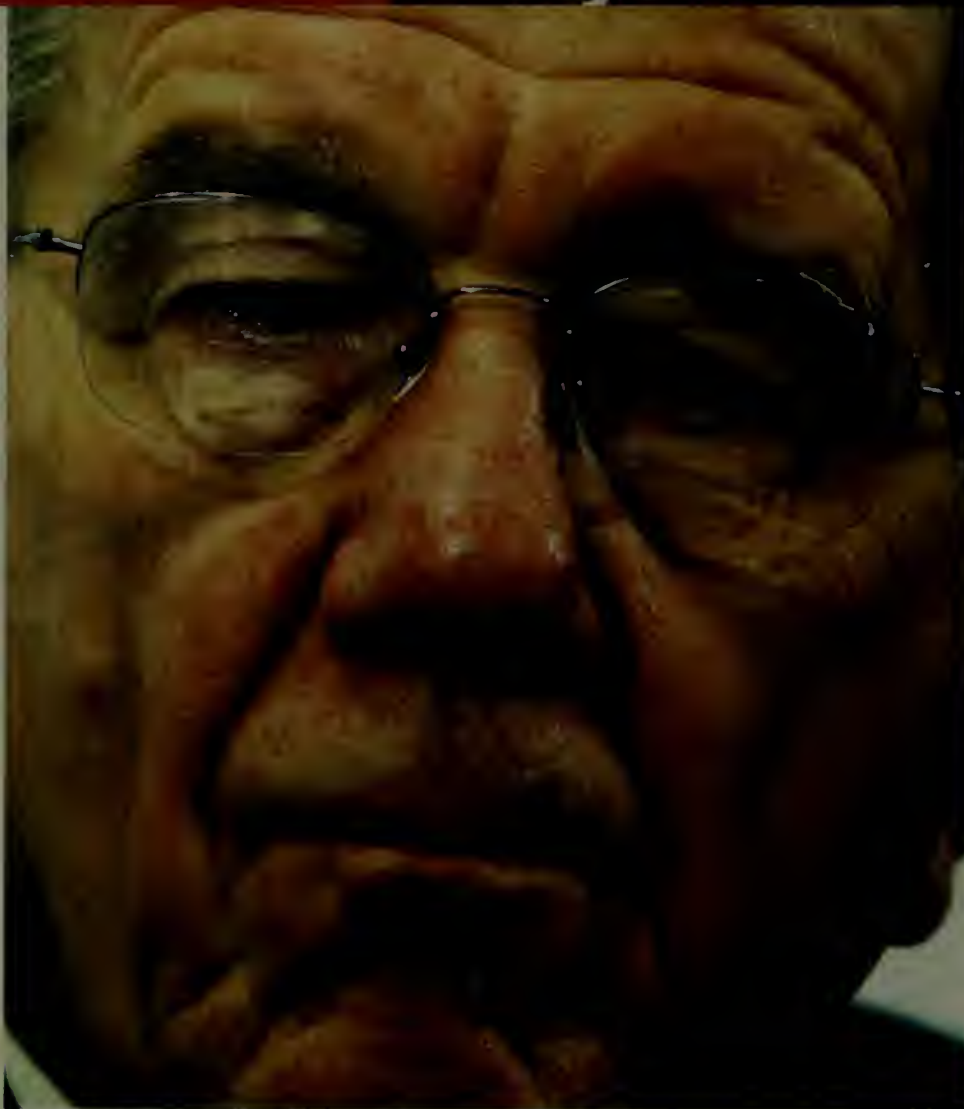
GHOSN Setting an example at Nissan

to appease Dalton Investments, which owns more than 5% of the pharmaceutical maker.

Those were mere skirmishes compared with a battle that broke out in February. That's when Japanese startup Livedoor Co. went public with a hostile bid for Nippon Broadcasting System Inc., the top shareholder in No. 1 broadcaster Fuji Television Network Inc. Fuji and NBS have attempted to thwart the takeover, but the outcome remains unclear. Even if Fuji wins, the fight serves as a reminder to all Japanese companies that the rules are changing. Stringer and other “blue-eyed” execs may be lonely *gaijin* in the boardroom, but they'll benefit from working in a transformed Japan Inc. ■

—With Hiroko Tashiro in Tokyo





SCANDALS

WHY BOEING'S CULTURE BREEDS TURMOIL

The sacking of Stonecipher won't fix a company marked by excess and infighting

IT WAS AT THE "PALM SPRINGS Fling," Boeing's annual executive retreat held two months ago, that CEO Harry Stonecipher, 68, initiated the relationship with Boeing exec Debra Peabody that would lead to his shocking ouster announced on Mar. 6. The conference epitomized much that is still wrong within Boeing, insiders say. Attendees describe heavy drinking and late-night revelries. It was an atmosphere at odds with the pro-

fessionalism Stonecipher had tried to project after taking over the CEO spot in 2003 when Philip M. Condit resigned amid a string of scandals. Stonecipher could not be reached for comment.

From the outside, Stonecipher appeared to have made progress in returning Boeing to the straight and narrow. The aerospace giant's two most important units, Boeing Commercial Airplane and Integrated Defense Systems, had become solidly profitable. Just days before

STONECIPHER
He was cleaning up after Condit

Stonecipher's resignation, the U.S. Air Force lifted a 20-month ban that prevented

from bidding on rocket contracts. The company had been excluded after top-level managers admitted in 2003 to leaking internal Lockheed documents to Boeing's bids. With the February sentencing of Michael Sears, the former Boeing financial officer, on charges of illegal employment negotiations, Boeing was putting its most serious scandal behind it. Indeed, its stock had regained all its losses, rising to almost \$60 from under \$40 the past year.

AN OBLIVIOUS BOARD

BOEING'S BOARD, led by Chairman Lewis Platt, presented the ouster as evidence of a company so committed to ethical purity that under current circumstances it wouldn't tolerate even a consensual sexual relationship between the CEO and a female exec. Inside, another story. They describe an onetime culture of unrestrained excess that dates back to the Condit years. The lack of restraint also led to rampant politicking and fighting among senior managers during Stonecipher's tenure—never envisioned as lasting more than a few years—on, the battles among those angling to succeed him intensified. The board, meanwhile, seemed oblivious to the turmoil. Board members declined to comment for this story, but Platt told reporters and analysts in a phone conference announcing Stonecipher's resignation, "We are committed to strong ethical leadership, and we have fought hard to restore our reputation."

Executive-suite shenanigans and infighting are hardly unknown in Corporate America, but the degree to which they pervade Boeing is rare. For a company that must negotiate with government and take responsibility for the safety of the flying public as well as sensitive military contracts, the distractions are particularly troubling.

Just days before the Stonecipher announcement, Boeing was awash in rumors that a major shakeup was imminent. A long-planned board meeting the previous weekend ran an extra day and a half, and executives scheduled to present to the board were told at the last minute to stay home. It was a distraction from Boeing, still negotiating hard-to-renew relationships at the Pentagon, did need. The all-important commercial division was embroiled in a cutthroat competition to win back the dominant share

airline business from Eu-
s Airbus.

in the midst of this turmoil,
mercial division head Alan
Mulally held court at a party
in Kirkland, Wash., attended by
managers and employees
days before the Stoneci-
bombshell. According to
al attendees, Mulally talked
ly about who would replace
ecipher, calling it a two-
e race between himself and
s McNerney, who is the
of 3M, a Boeing director,
a former top General Elec-
o. exec. These same people
e Mulally as saying: "It's
down to the GE guy or me.

fight to the death, and if it's him, I'm
here." Mulally denies making the
ment. McNerney has declined to
ment on whether he is a candidate for
ecipher's job.

Mulally wasn't the only exec plotting
scent in recent years. In fact, one of
most serious rivals may have taken
nachinations to such an extreme that
led him to unlawful conduct. For-
CFO Michael Sears was sentenced to
months in prison in February for his
in the illegal job negotiations with
Force procurement officer Darleen
Druyun. Insiders say the controversy was



ALBAUGH A front-runner in
the CEO race



MULALLY Talking openly
about becoming CEO?

part of his attempt to amass a power base
at his rivals' expense.

In 2002, Druyun, an Air Force pro-
curement czar looking to move to the
private sector, was possibly the most
sought-after executive-to-be in the aero-
space industry. With her understanding
of the Pentagon procurement process
and her contacts, Boeing, and most of its
rivals, tried hard to land her. James F. Al-
baugh, a front-runner in the Boeing CEO
race and head of Boeing's Integrated De-
fense Systems, talked with her at least
once under the assumption that she had
recused herself from contract negotia-

tions with Boeing, but he came
up dry. It was only when Sears
went back for one last try that
Boeing had a deal, according to
e-mail released as part of the
criminal investigation of Sears
and Druyun. That coup gave
Sears a huge advantage over
both Albaugh and Mulally. It
also had the potential to expand
his power base by making
Druyun an ally. Sears previous-
ly declined to comment
through an attorney and could
not be reached for this story.

It took a lot more than per-
suasive skills to sign up
Druyun. The clincher: Sears
promised her a top job even

though she was still negotiating con-
tracts with Boeing.

Sears found other ways to advance his
cause. In the summer of 2003 he waged
all-out war with then-CEO Condit. Sears,
according to several senior Boeing exec-
utives, took over all public-relations re-
sponsibilities and controlled access to the
media and investors, an unusual role for
a CFO. "It was clear to everybody [that]
Sears was anxious to be the successor to
Phil to the point that it got pretty dis-
gusting," said a Boeing board member
earlier this year. "You got tired of him
acting like the heir apparent." Sears

Season of Scandal



767 TANKER
Boeing hoped
to lease them
to the Air Force

JULY 2003 The Pentagon punishes
Boeing for possessing proprietary
rocket-launch documents from rival
Lockheed-Martin. It bans Boeing from
military-satellite launches for
months and awards a \$1 billion
contract to Lockheed.

SEPTEMBER Controversy erupts over a
\$2.2 billion deal in which the Air Force
agrees to lease midair refueling tankers
from Boeing—a far pricier option than if
the government bought them outright.

MID-NOVEMBER The scandal widens
amid reports that Pentagon procurement
official Darleen Druyun tipped off Boeing
to the price Airbus offered for the tankers.

LATE NOVEMBER Following revelations
that CFO Mike Sears offered Druyun a job
at Boeing while she was still at the
Pentagon, Sears is forced to resign. The
Pentagon orders a review of the Air Force
tanker contract.

DECEMBER CEO Phil Condit resigns, laid
low by the ongoing scandals, mounting

business woes, and personal lapses.
Harry Stonecipher is named CEO.

MARCH 2004 Boeing agrees to pay
more than \$70 million to settle a class
action alleging it underpaid and denied
promotions to female employees.

FALL 2004 Sears pleads guilty to aiding
illegal employment negotiations and
is later sentenced to four months in
prison. Druyun pleads guilty to giving
Boeing preferential treatment. Boeing
takes a \$195 million charge to cover
the indefinite suspension of the tanker
program.

FEBRUARY 2005 The Pentagon
announces a probe into eight more Air
Force contracts handled by Druyun,
worth a total of about \$3 billion.

MARCH Stonecipher is forced to resign
over an affair with Boeing executive
Debra Peabody.

also took control of Boeing's famed in-house leadership center in St. Louis, according to several executives with knowledge of the matter. Banished from the sessions were Albaugh and Mulally. With almost every exec of any clout passing through the school, it gave Sears a huge profile throughout Boeing's far-flung empire.

Sears's stock rose in the summer of 2003. While he was still in charge of PR,

Executive backstabbing has been out of control for years

there were leaks to the media implying that Albaugh withheld information about a \$1.2 billion charge. Albaugh seemed to blame Sears. According to an internal Boeing memo written at the time, Albaugh said the "efforts to cast the write-down as the result of me withholding information—surprising world headquarters—is not supported by facts." He went on to write: "If Mike is intent on discrediting me, he does a disservice not only to me but to the company."

The backstabbing was widespread among the top brass. "It was everybody in the suite gunning for Phil's job," said a former senior Boeing executive with direct knowledge of the situation. "It was pretty destructive."

An unhealthy focus on internal politics wasn't Boeing's only culture problem. In March, 2004, Boeing agreed to pay \$70 million to settle a sprawling class action alleging widespread sexual discrimination. Sexual misconduct by executives was a frequent topic of conversation among employees. As *BusinessWeek* reported in December, 2003, Condit settled at least one wrongful termination lawsuit brought by a female employee with whom he had a relationship. Boeing has consistently opposed *BusinessWeek's* attempts to unseal documents dealing with these and other charges.

One of Stonecipher's top goals when he was brought out of retirement as CEO was to put ethics front and center. He created an internal governance office that reported to him and required every employee to sign an ethics statement. "Without integrity you cannot conduct business successfully," he wrote in the June, 2004, issue of Boeing's in-house magazine. "Firing people who lack integrity is good business." Words to live by. ■

—By Stanley Holmes in Seattle

SCANDALS

A Painful Lesson: E-mail is Forever

How could they be so dumb? As the Internet Age starts its second decade, senior executives continue to send off careless e-mails, which later get them fired or sent to jail. Boeing Co. CEO Harry C. Stonecipher is just the latest case. Explicit e-mails he allegedly sent led to his ouster on Mar. 7.

If Stonecipher had been paying attention, he would have seen that e-mails brought about the fall of Credit Suisse First Boston tech banker Frank Quattrone and Merrill Lynch & Co. analyst Henry M. Blodgett, as well as senior executives from Enron Corp. Indeed, it has been an enormous frustration to prosecutors in WorldCom Inc.'s \$11 billion fraud case that former CEO Bernard J. Ebbers managed to avoid e-mail.

Ebbers aside, few office workers can afford to shun e-mail. Yet clearly, many overlook the risks. Why? Whipped off in seconds, e-mail is nearly as spontaneous and carefree as talking. And with private and company mail commingling in the same inbox, e-mail can appear less consequential than a note on company stationery. However, e-mail is far more dangerous. The messages spread willy-nilly and remain stored on corporate servers, each poorly chosen word as inviolate as the Magna Carta.

Is the latest incarnation of e-mail, instant messaging, any safer? Not necessarily. One in 10 U.S. companies tracks and records IMs, which are used by nearly 80% of U.S. office workers, according to a survey by the Columbus (Ohio)-based ePolicy Institute. What's more, the recipient of the message—or that person's company—can keep records of the instant chats. And for those who count on Web services such as Hotmail or Yahoo!

Mail to provide an end-around to company controls, think again. "Some companies are already monitoring Web mail," says Nancy Flynn, executive director of ePoll.

For prosecutors and plaintiffs' attorneys, the avalanche of e-messages dishes up smorgasbord of evidence for everything from age discrimination to price fixing at hedge funds. "Some 70% of the evidence that we routinely deal with is in the form of electronic communication," says Garry Mathiason, a senior partner at Littler Mendelson in San Francisco.

And that tower of evidence will only grow. Why? To comply with new laws, such as the financial disclosure regulations in the Sarbanes-Oxley Act, companies must warehouse ever more e-mail, instant messages, blog postings, and other data. At the same time, new digital technologies promise to add to the flow. As companies adopt Internet telephony,



for example, it will be technically feasible for corporate sleuths and police to monitor records of Net-based phone talk.

Already, companies are rushing to install systems to filter loads of electronic traffic. Using natural-language software, they sift through e-mails and IMs in milliseconds, checking for trade secrets, bad language, porn, or pirated music files. "We look at every piece of mail while it's in motion," says Chris Voice, vice-president for technology at Entrust Inc., a Dallas-based messaging security company.

Such filtering systems should help companies sidestep legal woes. But what about an employee who's aching to communicate privately? The best advice is to steer clear of the digital world. Avoid phones. Whisper, if need be. Or wink.

—By Stephen Baker in New York, with Brian Grow in Atlanta

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EXECUTIVE SUITE

HANDICAPPING THE HP HOPEFULS

Techdom's top names are popping up as the search to replace Carly hits overdrive

HEWLETT-PACKARD CO.'S search for a new chief executive—only the sixth permanent chief in the tech giant's 66-year history—is gathering momentum. A successor to former CEO Carleton S. Fiorina could be named as early as the end of March, just seven weeks after Fiorina was forced out. And as the list of candidates narrows, at least one surprising name has popped up. Richard E. Belluzzo, a longtime HP exec who now runs data-storage company Quantum Corp., has emerged as “a strong candidate,” according to two sources close to the search.

The list of candidates remains in flux, but a number of high-powered execs have been approached. Sources familiar with the search confirm that other names include 3M Chief Executive W. James McNerney Jr., Intel Executive Vice-President Sean M. Maloney, Symantec CEO John Thompson, and John Joyce, IBM senior vice-president of global services. These executives say they are not interested in the HP job, but the board continues to vet potential candidates, with would-be CEOs presenting proposals about strategy.

Finding the right candidate fast is critical. Often such searches take three to six months. But the company has little time to waste as it struggles to improve internal execution and stem losses to rivals Dell Inc. and IBM. Since the start of 2004, HP's stock is

down 8%, trailing nearly every competitor, while Dell's price has soared 20% during the same period. Even if a new CEO is named by the end of March, it could take months to settle on a firm agenda for reviving the company. “You'd have to get into the trenches of this company for six months to figure out a plan that will win,” says Jeffrey Christian, the executive recruiter who spearheaded the search that brought in Fiorina in 1999.

“ROCKET RICK”

WOULD BELLUZZO be the right man for the job? The 51-year-old executive certainly knows HP's businesses and culture. After joining HP as an accountant in 1975, he earned the nickname “Rocket Rick” as his operations and distribution skills propelled him to the top of company's printer and computing businesses. Known for his hard-working ways, he executed the plan of mentor Richard A. Hackborn, an influential HP director, to make the company a powerhouse in high-volume con-

sumer markets. While he was deemed company's heir apparent before he left the CEO job at Silicon Graphics Inc. in 1998, some say his focus on consumer products led to the decline of HP's core rate computing unit.

Belluzzo's post-HP track record, however, has been lackluster. His effort to turn around Silicon Graphics foundered after a move to Windows-based servers failed to work; that was followed by a rocky stint as the No. 3 at Microsoft. Since becoming chief executive of Quantum in 2002, Belluzzo has earned a reputation for cost-cutting and crafting a new plan for the data-storage company. Meanwhile, the company's stock has inched up 3% during his tenure. Belluzzo did not return numerous calls seeking comment, and an HP spokesman declined to discuss the search.

Whoever steps into the corner obviously will face a challenging task. He will have some room to maneuver despite calls from Wall Street to break up the company, HP's board has publicly stated that it expects the new chief executive to manage businesses ranging from digital TVs to tech services. But any candidate who spoke with the board about the internal message isn't so inflexible. The board is open to considering strategic options, such as spinning off the unit or the printer division. An HP insider adds that while it's unlikely they will hire someone pushing a spin-off, HP is “open to discussion over strategy.” Whichever big-name exec that turns out to be, the key is finding the right fit—faster the better. ■

—By Ben Elgin, Cliff Edwards, Peter Burrows in San Mateo, Calif., with Michael Arndt in Chicago

In the Running...

RICK BELLUZZO CEO of Quantum

In 23 years at HP, he showed operations and distribution smarts while making HP a consumer power. But he also presided over a decline in HP's corporate markets.



...and Some Who Have Opted Out

SEAN MALONEY Executive VP at Intel

Broad management experience, plus strong motivational skills and an ability to manage talent, make him a draw.

JOHN THOMPSON CEO of Symantec

Thompson tripled revenues at Symantec and could help address HP's weakness in software.

JAMES MCNERNEY CEO of 3M

The one-time finalist for GE's top job has mastered broad portfolio management—something sorely needed at HP.

JOHN JOYCE Senior VP of global services, IBM

Big Blue's former CFO, he could help HP rebuild credibility with investors and bolster its tech services.

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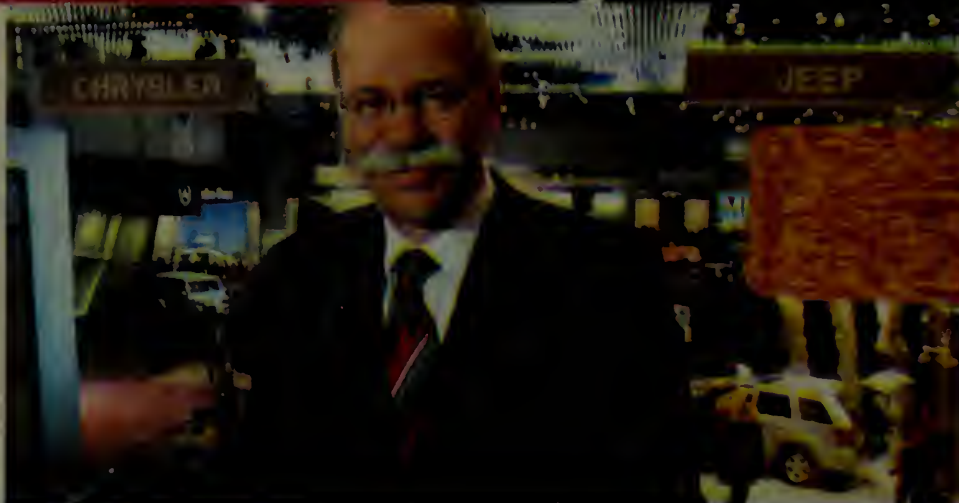
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STANDARD
& POOR'S





CARMAKERS

THE ZOOM MACHINE AT CHRYSLER

With a slew of new models—including the hot 300 sedan—its momentum is building

WHEN CHRYSLER Group Chief Executive Dieter Zetsche grabbed an electric guitar out of a musician's hands and smashed the glass concealing the Dodge Caliber concept car on Mar. 1, he jolted the genteel Geneva International Motor Show. While the stunt was a ploy to publicize plans to launch the Dodge brand in Europe next year, it also signaled the return of a brash exuberance that characterized the Chrysler of yore.

Zetsche & Co. have reason to feel heady. Led by the runaway success of the Chrysler 300 sedan, sales rose 7.5% in February, even as other domestic auto makers suffered declines. Remarkably, the sales increase came despite a 6% drop in incentives, to an average of \$3,760 last month, according to Merrill Lynch & Co. The fast start follows a stellar 2004, when Chrysler earned \$1.9 billion in operating profits. Not bad, compared with a \$637 million loss in '03.

Can Chrysler, which has often veered from triumph to setback, keep the revival rolling? The answer seems to be yes. Most analysts say Chrysler has enough decent product in the pipeline to remain profitable for the next few years. "Their

costs are under control, they've reduced capital expenditures, and they're launching successful products," says Dresdner Kleinwort Wasserstein analyst Jens Schattner. "This is the perfect mix to be successful."

For now the momentum is being stoked by the Chrysler 300. In a market jammed with well-engineered, competitively priced cars, the 300's bold style stands out. Even better, its popularity appears to have legs. Jeremy P. Anwyl, president of auto researcher Edmunds.com Inc., notes that incentives on the 300 have fallen—from \$1,500 at launch last April to \$900 today, signaling strong consumer interest.

Chrysler's future isn't riding on the 300 alone. Other 2004 introductions, notably the Dodge Magnum sport wagon and updated versions of the Dodge Caravan and Chrysler Town & Country minivans, are off to a strong start. Chrysler is now pinning its hopes

ZETSCHE on the recently Enjoying launched Jeep Cherokee and the I heady days Cherokee and the I Charger—an amped sedan version of the Magnum that riving this summer. The point, Zetsche, is that Chrysler is no long lying on a single hit to goose pl "Today we have four or five pillars.

KEEPING COSTS LOW

TO KEEP THAT UP, Chrysler is slicing dicing the market. It's inventing p derivatives of existing models, including the Mega Cab, a six-seater version o Ram pickup that arrives this fall. Chrysler brands are moving into o tapped markets. The Commander, w also hits showrooms this fall, is Jeep's ay into full-size three-row sport utilit hicles—a move applauded by anal The Nitro concept, meanwhile, l heralds Dodge's move into the pop small SUV segment next year.

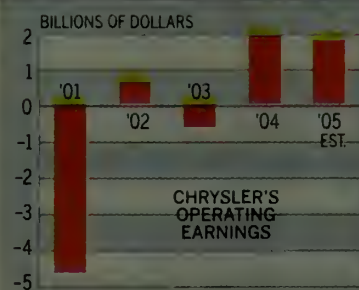
For the long haul, Chrysler's fu also rides on its next generation of s cars—a perennially money-losing ment for Detroit. Small cars are unli

DODGE CALIBER

to become Chrys bread and butter, b modest success co eliminate red ink. sporty Caliber ha back concept unve in Geneva—with fuel-efficient engir offers hints of w the 2006 replacem for the Dodge N will look like. The C iber will be based the last vehicle cha co-developed w struggling Mitsubi. Chrysler will go ahe alone with a mids sedan to replace Dodge Stratus a Chrysler Sebring late '06. The trick, analysts, will be keep costs low, sir



PROFIT TRACTION?



Data: DaimlerChrysler; Dresdner Kleinwort Wasserstein

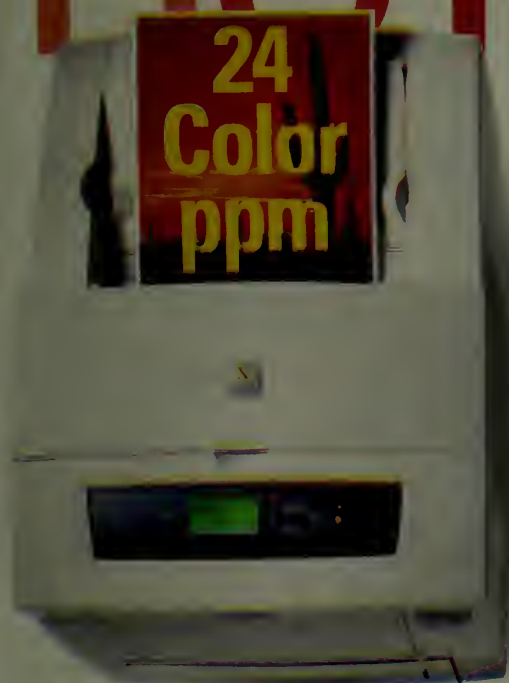
the economies of scale planned for a jo Chrysler-Mitsubishi program are longer in the cards.

Zetsche's task is to launch all these n models smoothly and then keep the pro duct-development machine tuned up al cranking out worthy successors. He counting on more hits to keep th Chrysler revival from being followed yet another crash. ■

—By Kathleen Kerwin in Geneva, wi
David Welch in Detr

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COMMENTARY

BY MICHAEL J. MANDEL

Now Workers Can Flex Some Muscle

As labor markets tighten, employees are gaining bargaining power

IN ANY ECONOMIC expansion there comes a moment when the balance of power shifts to employees from employers—a moment when the question of the day switches from “Can I get a good job?” to “Can we find enough good workers?” That moment may have come for the U.S. On the surface, the latest employment report from the Bureau of Labor Statistics wasn’t good

news for workers. The unemployment rate rose in February to 5.4%, from 5.2% in the previous month. Nor did hourly pay increase at all.

A closer look at the numbers, however, tells a different story. The number of unemployed “job losers”—those who are laid off or who otherwise involuntarily find themselves out of work—actually fell in February. Instead, much of the increase in unemployment was driven by a surge in “job leavers”—workers who voluntarily quit. Indeed, the number of unemployed job leavers rose to 965,000 in February, the second-highest monthly level since 1993.

In the past, such a sharp increase in people choosing to quit their jobs has been an indication of a power shift in the labor market. It shows that workers feel confident enough to leave their jobs—and strong enough to bargain for higher wages. In mid-1985, for example, a rush of people quitting of their own accord briefly helped push up the unemployment rate. What followed, however, was 18 months of rising real wages, the first sustained increase in pay in nearly a decade. Similarly, there was a rapid rise in unemployed job leavers in the second half of 1996—and that was a precursor to the very strong real wage increases of 1997.

The same thing may be happening again. “The labor markets have firmed, and it’s no longer a buyer’s market for talent,” says Laura Sejen, practice director of strategic rewards for Watson Wyatt Worldwide, a human resources consulting firm. “That’s particularly true for critical skill employees and top performers. They have options.”

Certainly that’s the case for Paolo Asuncion, a graphic designer and production manager for a Silicon Valley ad agency. In 2004 he was working at a lower-level temp



PICKY Paolo Asuncion, a graphic designer and production manager for a Silicon Valley ad agency, is looking for a better job.

job at another company. But when that company offered him a full-time position, he turned it down. Not only was the pay low, Asuncion says, “there seemed to be more opportunities there.” After looking for a month, he found his current job. He adds, his job responsibility and title are “at the level I was before the crash” and his pay is “close to what I made before.”

Asuncion’s experience will likely become more common even if the overall jobless rate doesn’t fall much. Once the advice tips toward workers, corporate hiring behavior can change almost overnight. If employers find themselves with positions they need to fill, says Barry Gerhart, a human resources expert at the University of Wisconsin Business School, “all of a sudden they have to shift back to recruitment-retention mode.”

There’s other evidence that the labor market is on the cusp of change. In February, the Conference Board reported that 22.6% of those interviewed in its monthly survey said jobs were “hard to get,” the lowest reading since 2002. And the index of newspaper help-wanted ads, also compiled by the Conference Board, ticked up in February to 41—its highest in two years.

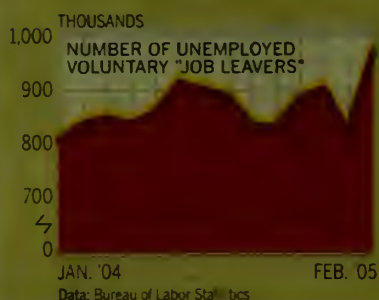
Plenty of pessimism still exists. Fears of losing jobs to China and other fast-growing rivals remain, some key industries such as telecom continue to cut jobs, and recent merger news will inevitably lead to layoffs.

But even that anxiety may soon melt away, with the economy growing at a steady 4.5% clip since early 2003 and adding 3 million jobs over that same period, erasing the job losses of the bust. Workers are beginning to realize that the option of quitting a job to find a better one is very real—and employers are going to have to ante up.

—With Jennifer Merritt in New York

LOOKING UP

More workers are quitting their jobs to search for better ones



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EDITED BY MONICA GAGNIER

HEADLINER

PAUL E. JACOBS



SOMEDAY, SON...

After Irwin Jacobs founded wireless technology company Qualcomm in 1985, he shuttled his son Paul around the company, placing him in different management jobs. Now that grooming appears complete: On Mar. 8, the San Diego company announced that Paul will become CEO when his 71-year-old father retires in July.

Paul, 42, is taking over at a heady time. Qualcomm is flush with demand for its cell-phone chips and licenses for its CDMA technology, used by such major cellular carriers as Verizon Wireless. Analysts expect revenues will jump 23% this year, to \$6 billion, and profits will balloon 27%, to \$2.2 billion.

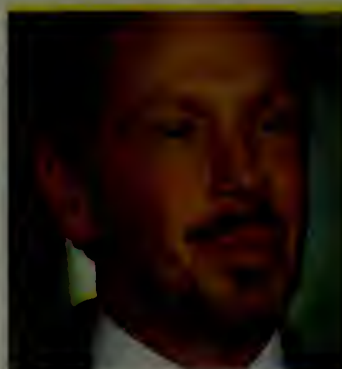
The younger Jacobs hopes to expand the markets for some of the technologies he's fostered at Qualcomm—including streaming video and data applications for cell phones. But he'll also need to recruit more foreign cellular companies to CDMA and to head off competition in cell-phone chips. If Paul ever needs any advice, Irwin won't be hard to find: He's staying on as chairman of the board.

—Arlene Weintraub

FIRMER WITH FANNIE

The regulators' grip on **Fannie Mae** keeps getting tighter. On Mar. 8, the board of the troubled mortgage giant accepted a new set of restrictions, including a pledge to separate permanently the jobs of chairman and CEO. The board also promised never to rehire the last man to hold both jobs—Franklin Raines, ousted on Dec. 21—or former Chief Financial Officer Timothy Howard. Fannie's agreement with the Office of Federal Housing Enterprise Oversight also calls for stricter controls on accounting entries. Fannie critic Representative Richard H. Baker (R-La.) wants to probe whether executives tampered with financial documents. Neither Fannie nor the regulator would comment.

ORACLE IS STILL HUNGRY



Oracle CEO Lawrence J. Ellison is at it again. Just two months after the Silicon Valley tycoon closed the \$10.3 billion hostile takeover of rival business software maker **PeopleSoft**, Ellison on Mar. 8 announced an unsolicited offer for **Retek**, a small Minneapolis company that makes software for retailers. The Oracle offer, \$9

per share, or about \$524 million cash, comes just eight days after German software maker **SAP** bid \$8.50 per share for Retek, raising the possibility of a bidding war. The fight between Oracle and SAP is getting testy. Two months ago, SAP acquired **TomorrowNow**, a Bryan (Tex.) consultant that has lured away software maintenance contracts from PeopleSoft.

J.D. POWER'S NEW DRIVER

The McGraw-Hill Companies, parent of *BusinessWeek*, agreed on Mar. 7 to acquire **J.D. Power & Associates** for an undisclosed sum. The Westlake Village (Calif.) company is best known for its annual surveys of quality and customer satisfaction in the auto business. Power mails its surveys to thousands of new car buyers every year and tallies the results. Winners pay for the right to advertise the J.D. Power seal of approval. The firm also sells data to companies and consults with them on how to improve their scores. McGraw-Hill expects Power to benefit from its new parent's global reach in financial services, construction, energy, and other major industries. After McGraw-Hill warned of earnings dilution because of the purchase and two other acquisitions and changes in pension plan assumptions, its shares fell 6.8%, to \$89.31, on Mar. 9.

CAPITAL ONE ROPES A BANK

What's in your wallet, pardner? **Capital One Financial**, which became the nation's fifth-largest credit-card issuer by marketing credit by mail, on the Web, and with its familiar TV campaign, is

making Texas the target of its first foray into bricks-and-mortar banking. On Mar. 8, the McLean (Va.) company announced it's paying \$1 billion to buy **Hibernia**, a Louisiana-based bank sprouting branches in Dallas and Houston. Cap One's plan is to fund consumer lending with cheaper bank deposits.

ET CETERA...

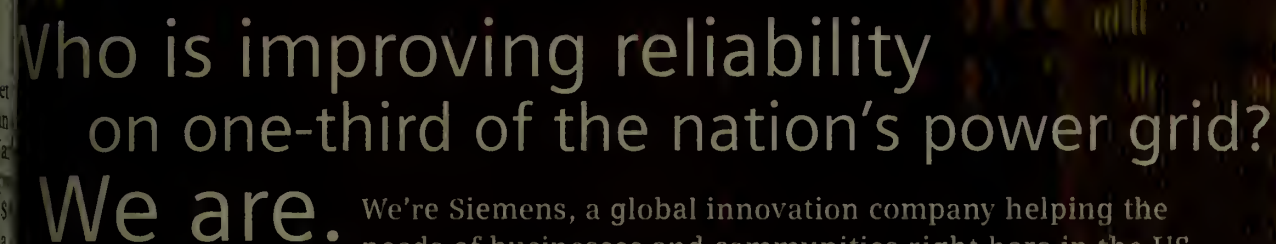
- Comcast will pay Motorola \$1 billion for set-top boxes and co-develop new technologies.
- AOL will soon offer Web phone calling to subscribers in 44 markets.
- Washington has approved the sale of IBM's PC division to China's **Lenovo Group**.

CLOSING BELL

Nearly two years into a comeback, **McDonald's** may be growing stale. On Mar. 8, the fast-food giant said same-store sales rose just 1.6% worldwide in February, with sales sliding 3.4% in Europe. The report sent McDonald's shares down 5% over two days, to \$32.53, on Mar. 9.



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Curtis Robb, CIO
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RICHARD S. DUNHAM

Private Accounts: Past Is Prologue...

PRESIDENT BUSH'S SOCIAL SECURITY struggles bring back painful memories for Gene Sperling, longtime chair of Bill Clinton's National Economic Council. Like the "Clinton care" health reform of 1993, Bush's ambitious plan to create private accounts has grown less popular as Americans learn more about it. Clinton's

elaborated proposal eventually drifted to the bottom after party members abandoned the sinking ship. The lesson, says Sperling: "Passing major reform becomes more and more difficult when you fill in the details." As political operatives try to assess the fate of Bush's embattled proposal, they are studying the pitfalls of major Presidential initiatives in recent years. If history is your guide, the outcome could follow one of two paths:

OSTLY VOTE. In 1993, Clinton persuaded Capitol Hill Democrats to back an unpopular deficit-reduction plan that featured the biggest tax increase in U.S. history. Like Bush today, Clinton faced a wall of partisan opposition. He twisted arms within his party and eked out a thin victory. That cost dozens of House supporters their seats in the 1994 midterm elections—a debacle from which Democrats have never recovered. Moderate House Republicans fear that their leadership will force them to vote for private accounts—only to strand them when the package falls far short of the 60 votes Bush needs in the Senate.

COMPLETE COLLAPSE. Democrats hope to replicate the stunning defeat the GOP inflicted on Clinton in the health debate of 1993-94. As support for the Clinton plan ebbed, Democrats offered red-drawn compromises, but Republicans refused to budge, choosing instead to parrass the President. Most Hill Democrats would rather force Bush to eat humble pie than hand him anything vaguely resembling a victory. "Democrats really feel they have him on the ropes," notes one business lobbyist.

SUPER SELL JOB. In 2001, Washington's elite declared that Bush had no mandate and no chance of winning a huge tax cut. But Bush took his case to the people and emerged victorious. Administration officials vow he'll do it again. A 60-city, 60-day sellathon is under way, and Bush allies predict the public mood will shift as the President educates wary Americans about the benefits of personal accounts. "Don't put anything beyond this guy when he is determined and focused," says Representative Nancy L. Johnson (R-Conn.), a moderate undecided about the Bush plan.

VICTORY BY ANY NAME. Most experts think the likely endgame for Social Security will resemble the 2004 Medicare prescription drug battle. Bush gave Hill Republicans wide latitude to put together a plan. Although he had quibbles with the final legislation, he signed it. The same thing happened in 1996 when Clinton, eager to "end welfare as we know it" before Election Day, accepted a reform bill similar to two he had vetoed. Bush will "put his arms around whatever comes out and say, 'Thank you for my Social Security package,'" says American University political scientist James A. Thurber.

The final outcome, of course, will be determined by the success—or failure—of Bush's marketing effort. While the possibility of a blowout victory seems remote, if the President starts to gain traction, moderate Democrats are likely to reach out to create a new, bipartisan retirement savings plan that does not divert Social Security payroll taxes. But if voters continue to believe that the solution is more dangerous than the problem, Bush could face his first big policy defeat. ■



CLINTON IN '93
His tax hike devastated the Democrats

CAPITAL WRAPUP

FARM SUPPORTS VS. FOOD STAMPS

Could the budget-cutting machete aimed at farm subsidies end up chopping food stamps instead? Liberals are increasingly worried about that risk. **President Bush** has asked for \$5.4 billion in cuts from agriculture programs over the next five years, mainly from crop supports. House and Senate budget writers will go along. But the actual cuts will be made by the Agriculture committees, which control spending for both farm subsidies and food stamps—a popular safety net for the poor and near-poor. With Congress feeling huge pressure from farm groups to save subsidies, liberals fear that food stamps could end up bearing the brunt.

THE FRENCH START KNOCKING HEADS

Tough guys on the Seine? *Quel changement!* More and more, Paris is getting out ahead of Washington with creative, hard-nosed stances on diplomatic problems. France spearheaded the U.N. resolution pressuring Syria to leave Lebanon. Now the French have devised a novel way to squeeze Iran over its nuclear program. Bush's idea—a worldwide ban on new uranium enrichment facilities—is a nonstarter for U.S. allies. So Paris is taking a more targeted approach, arguing that only countries in good standing under the Nuclear Non-Proliferation Treaty may operate commercial nukes. With its nuclear deceptions, Tehran flunks that test, France argues—so foreign contractors ought to be barred from completing Iran's Bushehr reactor. The missing piece: getting Russia, whose companies have the contract, on board.



ON THE NILE Sawiris wields plenty of political clout

EGYPT

WHERE WESTERN TELCOS FEAR TO TREAD

Egypt's Orascom is building an empire by making risk bets all over the Mideast—and beyond

NAGUIB SAWIRIS LIKES to travel into Baghdad incognito. The chairman and CEO of Orascom Telecom Holding, the Mideast's most successful cellular-service provider, has visited Iraq's war-torn capital four times since Saddam Hussein was toppled in 2003. "I take a small car from the airport," he says. "I sit next to the driver. I choose a hotel at random. I try not to stay more than one or two days."

Risky? Sure. But the 50-year-old Egyptian businessman has built up an empire by taking gambles. Sawiris' \$160 million investment in Iraqna, Iraq's top cellular network, is already throwing off profits of \$30 million to \$40 million a year, according to estimates, despite some \$2 million a month in security costs. The Iraq operation is a tiny piece of Orascom, whose networks serve close to 14 million subscribers spanning nine countries, from Tunisia to Pakistan. As such, it is one of just a handful of Arab companies with international reach.

Cairo-based Orascom is expected to report this month that 2004 net operating profit more than tripled, to \$843 million on revenues of \$2.2 billion, estimates investment bank EFG-Hermes Holding Co. No wonder the company's London-traded global depositary receipts have nearly quintupled in the past year, to around \$40. "[Sawiris] dared to do a lot of things and actually succeeded," says Serge Tchuruk, CEO of French telecom-equipment maker Alcatel, a key Orascom supplier.

A few years ago the Western world

of tales of fast-growing cell-phone companies. But for sheer audacity and sustained growth, it's hard to rival Orascom. Sawiris' outfit is one of the biggest companies in the Middle East outside the sector. The founder, son of an Egyptian construction magnate, has used his political savvy to get his networks built—sometimes tangling with well-connected figures when needed. His success and guts have turned him into an outspoken advocate for political and economic liberalization.

JOINING COMPETITION

FROM HIS PERCH on the 26th floor of his family's gold-domed Cairo office tower, Sawiris scours the developing world for investment opportunities. He favors markets with a combination of large populations and low telephone penetration rates. That's what Egypt was back in 1997, when Sawiris launched his career in telecommunications by bidding about \$500 million for one of two mobile licenses. Orascom's Czech-born chief financial officer, Aldo Bressan, compares the action to the mobile boom in Europe in the late 1990s. "We are still in the middle of it," says the former Credit Suisse First Boston banker. Sawiris has pretty much had his pick of properties in this corner of the world, where low incomes and difficult-to-navigate politics have discouraged Western investors. But he faces growing competition from Kuwait's Mobile Telecom Co., Turkey's Turkcell, as well as the likes of Vodafone and France Telecom's mobile unit, Orange. Still, Orascom—which is controlled by the Sawiris family—the advantage of nimbleness, while Westerners take their time hashing out deals. "You will find that I make decisions very quickly," says Sawiris while discussing a potential deal on his mobile. He is checking out possible buys in Burma, India, Indonesia, and Vietnam. Although Sawiris operates in markets not known for transparency, he says he won't resort to bribes to clinch a deal. But he is open to paying consultants' fees on successful transactions "if I can get an invoice." These countries' low per-capita incomes present no obstacle to Sawiris, who is to price his service low enough to appeal to the working class. Orascom recently paid \$60 million for the fourth-largest mobile network in Bangladesh, one of the poorest nations on earth. The payoff is a rapidly growing customer base. EFG-Hermès figures that Orascom's subscriber numbers will continue to grow at a compound annual rate of 34% through 2008, compared with 4% for Europe. In Egypt, Orascom affiliate and market

leader MobiNil is pitching its service at customers with incomes as low as \$50 per month. MobiNil CEO Osman Sultan says users typically pay an up-front fee of \$60 for a phone and stay connected for as little as \$2 per month using phone cards. MobiNil's average monthly revenues per user hover at around \$17, compared with \$40 in Europe. And the song from its TV ads for its "Alo" phone cards was a national hit.

Thanks to his success, Sawiris wields considerable political clout. At home in Egypt, he has helped bankroll *Al-Mousry Al-Youm*, a liberal pro-business newspaper. And unlike many people in the Arab world, he supported the overthrow of Saddam Hussein in Iraq. He thought that making "an example of one who had abused his authority" would send a powerful message to other backward regimes in the region, including the Syrians. But he is also bitterly disappointed by what he considers mis-

"You will find that I make decisions very quickly"

takes made by the U.S. in the postwar period.

Iraq has plenty of potential. Orascom affiliate Iraqna has signed up 700,000 subscribers since it began operations in December, 2003. While bandits and insurgents have blown up Iraqna's equipment and kidnapped employees, the company's chief executive, Alain Sainte Marie, remains

optimistic. "There are less and less problems," he says.

Sawiris' gambles almost brought Orascom to its knees a few years back. In 2001 he executed the most ambitious deal of his career, bidding \$737 million for a mobile license in Algeria—a \$300 million premium over rival France Telecom. Nowadays, Algeria accounts for 40% of his profits. A year later, Orascom led a consortium that paid \$450 million for a license in Tunisia. By November, 2002, concerns over Orascom's short-term debt had hammered its London-traded shares to 66¢.

To relieve pressure on the balance sheet, Sawiris was forced to sell properties, including Jordan's market-leading Fastlink. He also raised about \$250 million from two funds controlled by Yassir Arafat. Sawiris recently spent an estimated \$360 million to buy back big stakes in his Algerian and Tunisian businesses from the Palestinians.

Sawiris says he gained much of his business savvy from his father, Onsi Sawiris, who founded a construction company in 1950 only to have it nationalized in 1961 by the regime of Gamal Abdel Nasser. The elder Sawiris moved to Libya, where he minted a new fortune. The 74-year-old patriarch notes that unlike the heads of other Egyptian dynasties, he gave his three sons long leases when they were young entrepreneurs. His two other offspring run a construction company and a tourism venture.

Some investors wonder if Sawiris is building his empire just to sell it. "People think I would like to be acquired by one of the Vodafones of this world," he says. "But my ambition is to be one of the Vodafones." Given Sawiris' track record so far, that notion doesn't seem far-fetched. ■

—By Stanley Reed in Cairo



Orascom's Telecom Reach

HOLDINGS Owns stakes ranging from 44% to 100% in nine mobile phone companies, from Algeria to Pakistan. Sawiris family controls 57% of group

MARKET CAP \$8.6 billion

SUBSCRIBERS 13.8 million

MARKET RANK No. 1 in Algeria, Pakistan, Egypt, and Iraq. No. 2 in Tunisia and No. 4 in Bangladesh

REVENUES* \$3.2 billion

NET OPERATING PROFITS* \$1.13 billion

STOCK APPRECIATION 390%

*2005 estimate **In the past 12 months

Data: EFG-Hermès, BusinessWeek

RUSSIA

CRACKS ARE SHOWING IN THE KREMLIN

A messy fight over oil assets signals that Putin's administration is in disarray

THE SEEMINGLY NEVER-ending saga of the Yukos affair—the long-running feud between President Vladimir V. Putin and the Yukos oil giant of imprisoned oligarch Mikhail B. Khodorkovsky—looked as if it had reached a denouement in December, when the Kremlin confiscated Yuganskneftegaz, Yukos' main production subsidiary, and folded it into state oil company Rosneft. But as one battle fades from the headlines, a new one has taken its place, this time inside the walls of the Kremlin itself: the battle for the spoils.

That's how Kremlinologists are interpreting a bizarre series of events in early March, when Russia's two state energy companies, Gazprom and Rosneft, duked it out in public over the details of a long-delayed merger. In reality, Kremlin-watchers say, the two companies' managements are proxies for rival groups inside Putin's secretive Kremlin entourage. One group is led by the President's chief of staff, Dmitry Medvedev. The other is captained by his deputy chief of staff, Igor Sechin, a leader of the *silovik* (ex-KGB) faction that fought the war against Yukos. Each man looks to be angling for the job of chairman of a new state oil and gas behemoth to be created by the merger of Gazprom and Rosneft. "There's obviously a great big bun fight going on inside the corridors of power," says Chris Weafer, head of research at Russia's Alfa Bank.

The dispute over the Gaz-

prom-Rosneft merger is the latest sign that Putin's administration is in disarray. Struggles over everything from electricity reform to fiscal policy have split the Kremlin. But the tussle to control the new energy giant could be the biggest yet. Last December, Rosneft acquired Yugansk. The deal catapulted the small company into a major player but complicated plans by Gazprom to merge with Rosneft. After the auction, Yukos shareholders threatened to sue Rosneft. Gazprom did not want any exposure to ugly litigation.

On Mar. 3 it seemed the problem had been solved when Gazprom chief Alexei Miller announced that terms for the merger with Rosneft had been settled: Yugansk would remain a separate com-

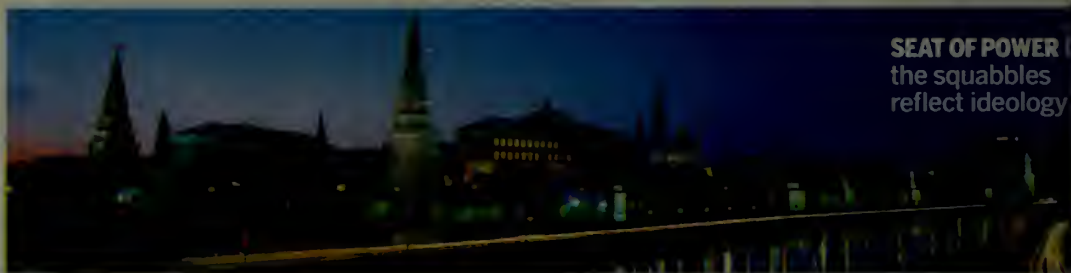
pany under Rosneft President S. Bogdanchikov. But he was angling for more. At any rate, on Mar. 4 Rosneft published a statement on its Web site contradicting Miller's assertion that Yugansk would not be included. Gazprom insisted Miller was right. Rosneft withdrew the statement on Mar. 5, calling it the result of a "technical error."

OUTRIGHT DEFIANCE

MEDVEDEV, WHO IN addition to his Kremlin job is chairman of Gazprom, is seen by many experts as a left-leaning Kremlin "liberal," has for now been outmaneuvered by Igor Sechin, who became chairman of Rosneft's board last summer. "This is the first time we've seen the *siloviki* badly beaten on a key issue," says Anders Aslund, senior fellow of the Russian & Eurasian Program at the Carnegie Endowment for International Peace in Washington.

Local Kremlinologists tend to be cynical, seeing little difference in principle between the two Kremlin groups. Increasingly open splits in the government, however, show that Putin's leadership is growing weaker. The confusion at the top is likely to get even more complicated as the battle to succeed Putin, under the constitution is supposed to end in 2008, heats up. But if Putin stops his closest advisers from squabbling, he's likely to have an even tougher time controlling the succession. ■

—By Jason Bush in Moscow



SEAT OF POWER The squabbles reflect ideology

Rumble on Red Square

At the heart of the controversy over the proposed merger of **Gazprom** and **Rosneft** is a battle among top Putin aides for control of Russian oil



ROSNEFT LOBBY

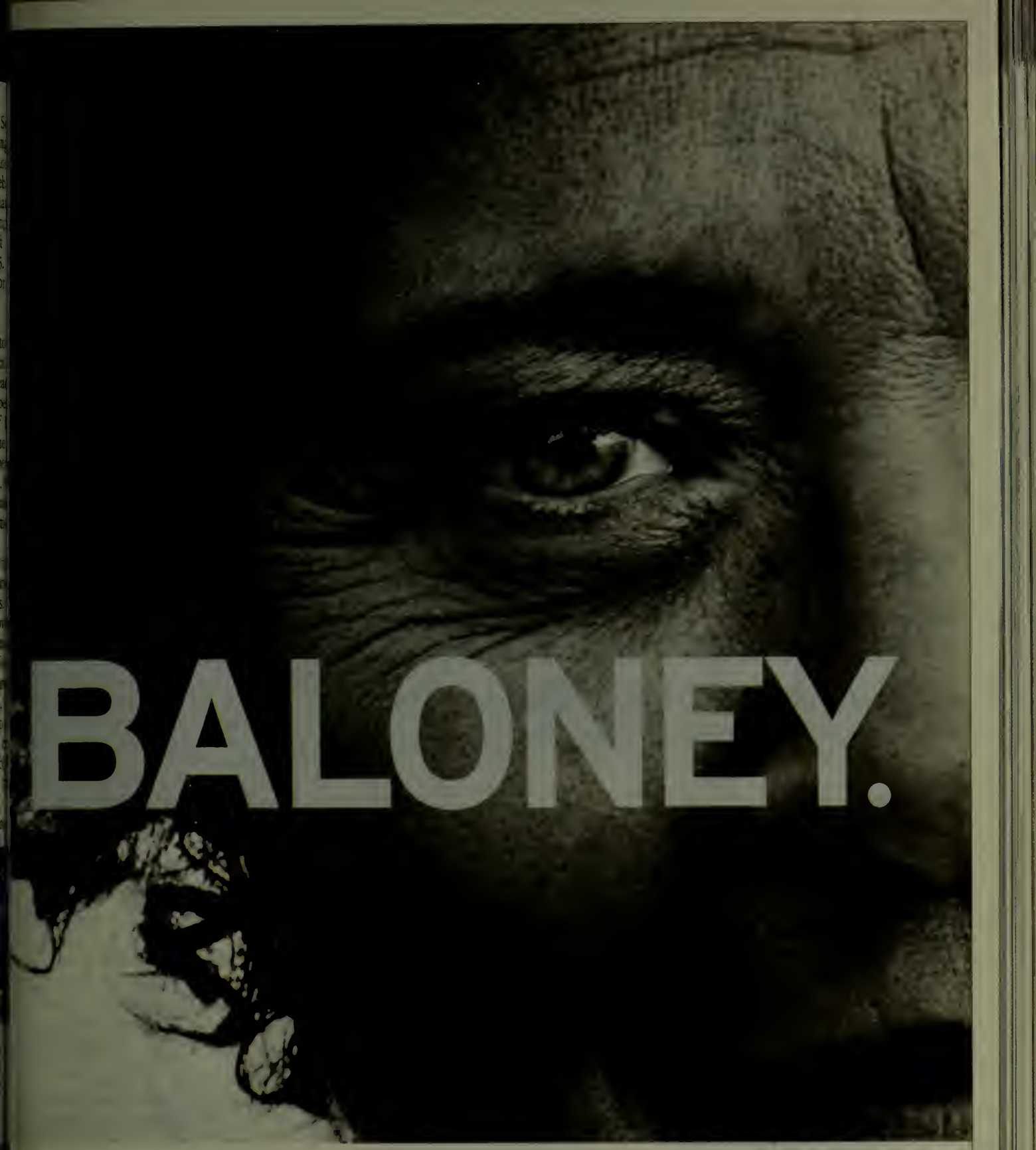
IGOR SECHIN Deputy head of the Kremlin staff and Chairman of Rosneft. One of Putin's closest and oldest associates, Sechin served as Putin's assistant in various posts in the St. Petersburg city government from 1991. A leader of the *silovik* (ex-KGB) faction in the Kremlin.

GAZPROM LOBBY

DMITRY MEDVEDEV Head of the Kremlin staff and Chairman of Gazprom. Dubbed a "liberal lawyer," Medvedev is a former law professor of Leningrad University and was legal adviser to the St. Petersburg mayor's office in the 1990s.

Data: Bloomberg





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INDIA

THE TIES THAT BIND DELHI AND WASHINGTON

Diplomats are starting to build on the two countries' strong business relations

AS U.S. CORPORATIONS rush to outsource everything from call centers to financial analysis to Bangalore or Bombay, business ties between India and the U.S. have never been stronger. The U.S. is India's largest trading partner, and two-way trade grew 17% last year, to \$21 billion. Politically, though, New Delhi and Washington haven't been quite as cozy. Although the two countries set aside their differences of the Cold War-era—when India typically sided with the Soviet Union—during the Clinton Administration, the Bush White House hasn't exploited the thaw, and there's a lingering sense of mistrust in the two capitals.

Now Washington seems poised to bring its political relations up to the same level as the commercial ties. On Mar. 16, Condoleezza Rice will make New Delhi the initial stop on her first trip to Asia as U.S. Secretary of State. On the agenda will be stronger defense ties, expanded commercial cooperation, and a possible India visit by President George W. Bush. Rice

will be followed in April by Transportation Secretary Norman Y. Mineta, who will sign an "open skies" agreement allowing Indian and U.S. airlines free access to each others' markets. "As India increasingly fills a global leadership role, we must build a strong bilateral partnership," Deputy Assistant Secretary of State Donald Camp told Congress on Mar. 2. Says Brahma Chellaney, a security analyst at the Centre for Policy Research in New Delhi: "India is ready for an equal strategic relationship."

Driving the rapprochement is concern over two regional rivals, China and Iran. Chinese Premier Wen Jiabao is expected in New Delhi in April to discuss commercial links and resolve border disputes. But analysts say Washington is eager to use India to create a counterbalance to China's growing strength in Asia. And the U.S. would like to keep India from getting too close to Iran, which has agreed to provide gas via a pipeline that would traverse

INDIAN SOLDIERS
U.S. companies want to bolster arms sales to India

Pakistan. "It's a basic balance of power politics on a grand scale, containing China

taining Iran," says South Asia Stephen P. Cohen of the Brookings Institution, a Washington think tank.

THORNY ISSUES

ANOTHER MOTIVATING factor is sales. Washington makes it hard for companies to sell advanced weapons to India, which has budgeted \$7.8 billion for defense purchases this year. U.S. companies would like a piece of that action. India usually buys from Russia, France and Israel. In recent months, Lockheed Martin Corp. has met Indian officials seeking to sell planes such as its C130 cargo haulers and F16 fighter jets. At the biennial Bangalore defense exhibition in February, U.S. companies including Lockheed, United Technologies, and Northrop Grumman, rented 10,800 square feet of display space—the second-biggest national representation (after Russia), and more than what they had at the last show in 2000.

Some thorny issues remain. When it comes to Iran and China, India's security interests "may not be the same as ours," Cohen says. India wants cordial ties with both countries, which loom large as commercial partners. The U.S. wants India to recognize Washington's security interests in the region. Pakistan, which has backed the U.S. fight against terrorists in Afghanistan, is a problem for India, though, has been at odds with the U.S. for more than five decades over Kashmir—the Himalayan state on the border—and bristles at the military and economic aid that the U.S. has shown

on Pakistan. Just as important, New Delhi resents Washington for not backing its bid for a seat on the Security Council. "India is there yet," says a U.S. State Dept. official.

Nonetheless, Rice is expected to get a warm hearing in New Delhi. Indian policymakers note that as National Security Adviser, Rice initiated the "Next Steps in Strategic Partnership,"

a bilateral pact for sharing technology in civilian nuclear and space activities. "India has shown an ability to think differently," says an Indian Foreign Ministry official. "We expect the ice to keep melting."

—By Manjeet Kripalani in Bombay
with Stan Crock in Washington

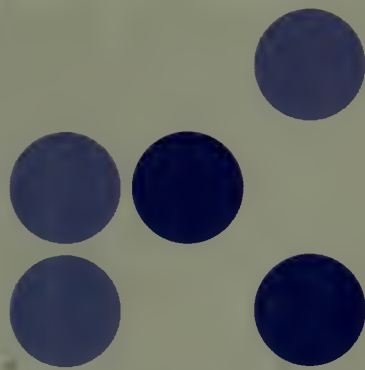
The U.S. is eager to use India to contain China and Iran



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Why the Next Pope May Be a Surprise

AS POPE JOHN PAUL II continues his recovery from a tracheotomy in Rome's Gemelli hospital, the Vatican says His Holiness will be well enough by Easter to give the traditional blessing. But more than ever the Polish pontiff's mortality is a topic of discussion in Vatican and church circles. That discussion, of course, leads to

the next question: Who will succeed John Paul II?

The College of Cardinals will select a Pope when John Paul passes on. But when the time comes for a conclave to anoint a new pontiff to lead the world's 1.1 billion Catholics, John Paul's influence will still be considerable. He has appointed 115 of the 120 cardinals eligible to elect the next Pope, all with an eye to enforcing his conservative stance on such issues as abortion, the role of women in the church, homosexuality, and bioethics. Meanwhile, liberals such as Cardinal Martini of Milan have entered mandatory retirement, strengthening the hand of the conservatives.

Far-Flung Cardinals

JOHN PAUL HAS also recruited cardinals from the poor but vibrant southern rim of Catholicism and from regions hardly ever represented before. New cardinals hail from as far away as Cameroon, Syria, and the Dominican Republic. "He has made the College more reflective of the global reality of the Church," says Harold W. Attridge, dean of the Yale Divinity School.

This widening of the ranks complicates the task of figuring out who the next Pope will be. "John Paul has conducted three planetary battles," says Orazio Petrosillo, a Vatican commentator: "Breaking down the wall between East and West, reducing the gap between North and South, and curbing the hostility between Christianity and Islam." If the college wants to focus on the North-South divide, it could select one of the so-called southern cardinals.

These are prelates from Africa, Asia, and

Latin America. *Papabili*—papal prospects—from this group include Nigeria's Francis Arinze, a conservative; Oscar Rodríguez Maradiaga, a Honduran known for his work with the poor; and India's Ivan Dias, a friend of Mother Teresa. The selection of Arinze as the first African Pope since Gelasius I, who died in the year 496, would certainly put the issue of poverty at the top of the agenda.

Big Shoes to Fill

THE QUESTION IS whether the College will go that far. Some observers think the cardinals want a transitional Pope, i.e. one older than 75 who will not reign for long. In that scenario, the next Pope could be

Joseph Ratzinger, a German who has been John Paul's enforcer on Church doctrine. During his short rule, Ratzinger, 78, would keep the Church focused on social conservatism.

The final unknown is the role of the Italian cardinals. They still control 38 seats in the College and may want one of their own. A favorite of this camp is Dioni-

gi Tettamanzi, Cardinal of Milan. Known for his diplomatic skills, he has his conservative credentials in order. He's close to Opus Dei, the ultraconservative Catholic group, and was a ghostwriter of John Paul's encyclical on bioethics.

Do any of these *papabili* have the ability to fill John Paul's shoes? John Paul's role in the battle against communism gave him a place in history most other popes never attained. But some of the tasks pursued by the Vatican—especially the struggle to elevate the world's poor—still leave room for dramatic action. ■

—By Maureen Kline in Milan



RECRUITER John Paul's successor could come from the Third World

GLOBAL WRAPUP

ISRAEL CRACKS DOWN ON DIRTY MONEY

THE LARGEST money-laundering investigation in Israel's history continues to grow in scope. On Mar. 7, authorities froze \$376 million in assets at a Tel Aviv branch of the country's largest bank, Hapoalim. More than two dozen of the bank's employees have been detained on the suspicion that they failed to report irregular transactions involving millions of dollars. Israeli investigators are looking into whether Russian businessmen, including money tycoon Vladimir Gusinsky and Leonid Nevzlin, a major shareholder in Yukos, used the bank to launder money. Both the men, who now have Israeli citizenship and are wanted in Moscow on criminal charges, have denied any wrongdoing. The year-long undercover operation is also zeroing in on Hapoalim branches in Luxembourg and France. Israel enacted an anti-money-laundering law in 2002, under intense U.S. pressure.

ARE LOS DOS AMIGOS ON THE OUTS?

RELATIONS BETWEEN Mexico and the U.S. are strained in a runup to a meeting by the leaders of the three member states of the North American Free Trade Agreement in Waco, Tex., on Mar. 23. On the eve of a Mexican one-day visit to Mexico City, U.S. Secretary of State **Condoleezza Rice**, President **Vicente Fox** described as "shameful" Washington's recent criticism of Mexico's record on human rights and war on drug trafficking. Still, Fox hopes to make progress on an immigration accord first discussed in pre-September days, when a friendlier Fox-Bush duo dubbed themselves "Los Dos Amigos."

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Compliance Strategies That Work

Since U.S. corporate scandals resulted in the 2002 legislation known as the Sarbanes-Oxley Act (SOX), enterprises have been struggling to achieve compliance with this wide-ranging and often confusing set of regulations. "Two words—Sarbanes-Oxley—are stirring fear, uncertainty, and doubt in the minds of financial and IT professionals across the U.S. and beyond," declares John Hagerty, vice president of research for AMR Research Inc. Yet, as companies close their books on the first financial year affected by SOX, business leaders are beginning to understand the nuances of compliance—including which strategies work and which actions organizations should avoid at all costs.

To share this knowledge among business decision makers, *BusinessWeek* Special Advertising Sections sponsored a virtual roundtable to explore the current thought about SOX compliance and enterprise risk management at large. With current research results from AMR Research as a framework, the roundtable brought together nine industry leaders with financial, legal, and technology expertise. This section represents a condensed version of a very lively discussion about SOX compliance strategies that work.

PARTICIPANTS

John Hagerty, vice president of research, AMR Research Inc. (Boston)

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David Kleinhans, vice president, performance management, Cognos Inc. (Ottawa, Ont.)

Lee Dittmar, principal, Deloitte Consulting (New York, N.Y.)

George P. Herrmann, CPA, vice president and CFO, and Daniel B. Langer, CPA, CIA, CCSA, Jefferson Wells International Inc. (Brookfield, Wis.)

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HAGERTY: Frankly, many companies decided that they were going to do what they had to do, not so much do what they probably should have done. Most of the activity companies focused on in 2004 was what was really necessary to get a clean attestation from their auditors at the end of the fiscal year.

In 2004, people spent about \$5.5 billion, mostly on internal headcount and also on external consultant services. Technology was a relatively small amount of the spending compared to the total. When we spoke to clients in November about their plans for 2005, they firmly understood that this is an ongoing process. So for 2005, we've raised the estimate for SOX spending to \$6.1 billion. Spending will be moving from a project orientation

photo: Michael Maloney



Hagerty of AMR Research says Sarbanes-Oxley is creating ripples beyond the U.S.

to an ongoing process orientation. The amount of technology spending is rising significantly, from 19% in 2004 to 28% in 2005.



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New Tool for Compliance

Visa Commercial Procurement Solutions

photo: Richard Binstadt



Corporate compliance is no longer strictly for accountants and attorneys. Because regulations such as Sarbanes-Oxley are so critical to enterprises, even service providers not normally considered players in your risk management strategy are offering tools and best practices that support compliance.

Commercial procurement solutions help companies better control and monitor spending, which is key to compliance. "With the increasing focus on spend management, organizations want to know where every penny is spent," explains David Cramer, senior vice president of Visa U.S.A., in San Francisco. "Replacing cash and checks with purchasing and corporate cards allows management to impose appropriate controls on employee spending more efficiently."

Buyers can also aggregate spending with preferred vendors to support negotiations for high-volume discounts. The data reporting delivered by commercial-procurement service providers, which includes a consolidated view of spending information, enhances transparency and visibility into payments, spending patterns, and even fraud—supporting the audit function.

As companies wrestle with compliance requirements, understanding what works best for other organizations is essential. Visa's comprehensive procure-to-pay best practices help companies optimize their commercial payment solutions while sharing knowledge about how other businesses are managing compliance, Cramer says. "It's a powerful way to gain the expertise you need to protect the enterprise."

Q: Jefferson Wells recently conducted a roundtable with 150 clients. What did that roundtable reveal in terms of lessons learned?

LANGER: A lot of the emphasis was on blocking and tackling, getting ready for attestation. The clients that seemed to be more relaxed and comfortable with

"Trying to fight compliance is like tilting at windmills. Once you realize that you must meet this requirement, it can become part of the fabric of running your company."

— John Hagerty, vice president of research, AMR Research

their process were those that had built in an effective "tone at the top" and an effective communication process throughout the organization. These clients have done a better job of integrating the focus on controls throughout the fabric of the organization, rather than just trying to focus exclusively on documenting and testing the controls in preparation for attestation. They've integrated it and educated people throughout the operating areas of the business to understand their responsibilities as related to controls.

Q: Is SOX a much bigger issue than most people realize?

DITTMAR: Yes, but the realization is growing even as the first year work is continuing. People thought they were racing to a finish line, when they were really racing to just a milestone on what is a longer journey. There is a big difference between achieving your first assertion and actually having a sustainable internal control program. It's after the first assertion that some of the biggest impacts start to reveal themselves—dealing with change, with the dynamic aspects of every business. As they raise their heads and recover from what's been a Herculean effort, our clients are starting to recognize the need to step back and think about the transition from a project to a program. By making changes in their organizations and their teams to address ongoing program management, companies can get some value out of what's been a cost so far, turn it into an investment, and actually get ROI.

HAGERTY: We ask this question all the time: "What do you want to get out of this?" About 80% of companies want to get some ROI out of it, and ROI can be extremely broad. It doesn't have to be just payback for what is actually done, but to try to find some improvement in the business associated with this, where about 20% say it's very much a tax on their business. So this

is about combining business improvement and actually combining compliance into one big phase.

Q: What are the global implications of this?

MCGRATH: What we've been trying to do through the breadth of our worldwide operations is assist multinational corporations and foreign enterprises with understanding the requirements of

photo: Lisa Quinones



"As they recover from what's been a Herculean effort, clients are starting to recognize the need to think about the transition from a (compliance) project to a program."

— Lee Dittmar, principal, Deloitte Consulting



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photo: Michael Maloney

"In year two, companies are looking for ways to reduce costs and increase efficiencies while they implement a repeatable environment for evaluating their internal control framework."

— Michael J. Duffy, president and CEO, OpenPages

Q: How are executives expecting technology to help them deal with risk management?

KLEINHANS: Although our customers realize software isn't SOX-compliant—organizations are—they are expecting a broad set of technology and application capabilities that are really addressed at the different areas of Sarbanes-Oxley compliance. And to give some specific examples, with Sections 302 and 906, a large financial services insurance customer has an automated, repeatable process for its balance sheet and income statement generation. But Sections 302 and 906 are asking it to expand that to a notes or cash flow or property look at the business. The process for collecting that information isn't in an application. That lack of capability is spawning a whole systems renewal phase that we see in the performance management market. In this example, our customer was looking to upgrade financial reporting and consolidation capability.

For Section 404, it's similar. We had a large apparel footwear customer that needed capabilities that didn't exist in its performance management systems

"Compliance used to be a low-participation, finance-driven activity; now it's becoming a broad-use capability, and there's high participation across the organization."

—David Kleinhans, vice president, Cognos

around audit, high visibility, and collaboration. It was looking for more of that, and again that's spawning a systems renewal investment. And then for 409, where the focus is on accelerating financial reporting and disclosure, we have customers telling us that, to do this, they require more management

input. They require more views of the business, views closer to the operational area, and it's driving a standardization agenda to reduce the complexity and de-customize some of the existing burdensome areas. So I think customers are clearly looking for technology to aid in three of those areas. These customers look to standardize on enterprise reporting and planning systems.

photo: Larry Evans



Sarbanes-Oxley, as well as understanding other corporate governance initiatives that have arisen as a result of Sarbanes-Oxley. Yet, education is not enough. We have helped develop process, as well. The idea is for our clients to use that education, use that process, and develop a framework that's going to survive and be used after this past year.

Q: What are the hot buttons for clients?

DUFFY: By mid-March, 75% of the publicly traded companies in the U.S. will have gone through their first internal controls audit. And that experience has proven to be a very time-consuming and expensive one for them—and frankly a largely manual process that they're not eager to repeat. In year two, companies are looking for ways to reduce costs and increase efficiencies while they implement a repeatable environment for evaluating their internal control framework across their enterprise. To do this they need to adopt and enforce best practices and are looking for scalable and sustainable software in order to make that possible. What we're seeing today is an exponential growth in the number of companies that are asking us about our solutions. Overall, companies seem to be much better informed now and are looking for real solutions, not just another electronic file cabinet for their spreadsheets.

Q: What are clients expecting from their enterprise software?

SAY: Customers expect their enterprise software vendor to be the first line of defense in terms of addressing any compliance issue. We're hearing three things from our customers. First of all, they're asking us to come up with a more intelligent way to address not only Sarbanes-Oxley but the multitude of industry, regional, and regulatory requirements that they face, because many companies are starting to look at this as a component of their entire risk management profile and their approach to reducing risk. Secondly, our customers are asking for more flexibility. They want the opportunity to bring on partners and third-party solutions to supplement their approach



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Our clients probably spent 2, 3, 4, or 5 times what they initially estimated to get it done. And they are skeptical of the ROI argument at this point."

— George P. Herrmann, CPA, vice president and CFO, Jefferson Wells

towards compliance. And third, they're asking for ongoing commitment. They know this isn't just a one-time thing so they want continued investment in terms of our platform and tools so they can reduce the cost of compliance on an ongoing basis, and perhaps permanently reduce the structure.

Q: Eric, you have a very strong financial background, with many years spent as CFO of public companies and chairman of an audit committee. With that expertise in mind, what are some of the key challenges that companies face when they're trying to test and evaluate their controls?

KELLER: The work is changing dramatically from '04 to '05. In 2004, the major focus was documenting controls and getting through the first year of compliance. I think most companies quite logically relied on a combination of consultants

and brute force. In 2005, the work is shifting substantially. First, there is a very clear realization that Sarbanes-Oxley is not a one-time event, such as Y2K, or perhaps, ISO9000. People realize Sarbanes-Oxley is an ongoing part of being a public company, and an ongoing part of life for financial organizations.

A second important change in 2005 is the shift from documentation to ensuring that control work is performed, and performed on time; that issues in the control environment are identified and addressed in real time so that management can respond promptly; and change management, such as management of controls that are no longer effective, or other changes within the business. The third challenge is how to reduce the huge costs—both direct and indirect—companies incurred by complying in 2004. Finance organizations now have very clear mandates from their boards of directors to reduce those costs while continuing to comply, and to gain greater business benefit from the effort.

MCGRATH: One somewhat overlooked aspect is the amendments to the organizational sentencing guidelines required by SOX. The sentencing guidelines require effective compliance and ethics programs for organizations. Organizations that adopt effective compliance programs can mitigate exposure or obtain reductions in sentences if they face criminal investigation or sentencing. One of the areas that could generate a criminal problem on a go-forward basis could be problems with financial reporting. So, internal controls over financial reporting are important not only for disclosure purposes, but also to prevent the corporation as an entity from becoming liable for future criminal activities, or at least allow for a possible mitigation of punishment. I think this area might be a focus for the upcoming year.



photo: Kris Hundt

"Internal controls over financial reporting are (also) important ... to prevent the corporation from becoming liable for future criminal activities, or at least allow for a possible mitigation of punishment." — Albert G. (Gerry) McGrath, Jr., partner, Baker & McKenzie

photo: The Saturn Lounge - Advertising Photography



Q: What about merger and acquisition activity?

MCGRATH: Public companies have spent a great deal of money over the last year in implementing the process for their own companies. Now, with an uptick in merger activities, acquiring companies will have to validate that prospective targets have in fact satisfied their 404 requirements. So, there's a bigger issue when trying to determine whether or not your company is going to acquire another company. From the due diligence standpoint of an acquirer you want to understand what the target company has done to satisfy its 404 obligations. You need to understand the systems and the procedures that were used in allowing the prospective target to make its 404 statements and determine whether or not the systems used are consistent with the acquiring company's 404 compliance initiatives. It's difficult enough in a merger to integrate combined companies; but now when you're trying to integrate analytical processes that were used to validate internal controls, it becomes a much more difficult process. It's something that needs to be addressed early on in the context of any type of acquisition activity.

Q: Good point. Let's talk about what all this costs. John, where was the investment been?

MAGERTY: When we first started surveying people in 2003, compliance was mostly a manual effort because a lot of technology was not available to address this problem. So people said they spent pittance, only about \$100 million. In 2004, that number jumped up to \$1.13 billion. That's an 1100% increase in technology spending. Now going from 2004 to 2005, it jumped again, by 22%, to \$1.7-plus billion, on technology spending. Depending upon who you talk to, you'll get different perspectives on what technologies are important. When we asked people what they thought they would spend their money on, they mentioned first-stage documentation and records management and remediation activities, followed by internal and external security, and business process management.

FERRMANN: Overall, our clients probably ended up spending maybe a factor of 2, 3, 4, or 5 times what they initially estimated. So I think they're still in somewhat of a shock over what it actually took to get it done. And our clients are skeptical of the ROI argument at this point. I know most of them are looking to spend less in '05, but I think what's actually going on is they're also seeing that there's not a lot of choice. They're coming to the conclusion that they've got to streamline their process. Right now, they've got to figure out how to access the right resources and automate what is currently a very manual process.

Q: How severe are the consequences of non-compliance?

MAGERTY: Folks are concerned with the significant punishment associated with restating their financial returns. Because it's all driven by investor confidence issues, companies that have a restatement generally show a 9.5% loss in market cap after one day; after 60 days, it's a loss of 18.2%. So that's what's driving the board, the CFO, and the CEO to make sure this is done appropriately—because no one wants to leave himself exposed.

Q: Are business executives shifting from a project orientation to a compliance program?

DITTMAR: Absolutely. I always ask executives, "Who has access to the information they need—and the information quality they need, where and when they need it?" I haven't had a single hand go up. And I think that's very telling, because one of the important goals of Sarbanes-Oxley is providing accurate, reliable, transparent, and timely financial information. Doing so can only help improve governance. Executives are realizing they need a program that includes controls assessment, monitoring, and reporting, but that they need a lot more. Companies need to integrate risk management, financial monitoring and reporting, and internal control monitoring and reporting. These aren't unrelated activities. The integration of these activities, and the convergence of compliance and performance management, will be enabled through technology.

Q: It's estimated that there are more than 30 areas of compliance that these large companies must address. Are clients starting to look at those as one single compliance issue?

DUFFY: Generally, companies are still very focused on just making sure they meet their compliance requirements. Forward-thinking companies are beginning to recognize that it makes more sense to think strategically about the value of implementing a formal "system of record" for their business. Their goal here is that as they evaluate controls that address many different areas of compliance within their business, they can essentially use the underlying framework and evaluation facilities to comply with a growing range of compliance areas, while gaining increased efficiency in their business.

LANGER: There really seems to be an increased emphasis on trying to address convergence issues. There is a range of different compliance-related challenges our clients are facing—

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Sustaining compliance with Sarbanes-Oxley in 2005 will require the generation and management of tens of thousands of discrete control activities, quite unlike the massive control documentation projects completed in 2004. The volume of work does not vanish, rather the nature of the work changes dramatically. In 2005, companies must test and evaluate controls intermittently throughout the year. A company with 1,000 controls will complete many tens of thousands, if not hundreds of thousands, of discrete control activities during a year. For example, just evaluating and testing the 1,000 controls will generate:

Type of Control Activity	Total Number of Activities
600 controls, test monthly	7,200
400 controls, test quarterly	1,600
1,000 controls, evaluate annually	1,000
@10% of tests and evaluations generate exceptions	980
10% of exceptions require remediation	490
Total testing and evaluation activities	11,270
At 10 worldwide locations	112,700

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not just 404 compliance, but Basel II, anti-money laundering, and ISO-related issues. We're trying to help them identify tools that help with the convergence of all these challenges they face.

DITTMAR: It's not just converging various compliance initiatives, but it's the con-

needs to be cost-effective, which means that you'll reduce the cost of compliance over time by automating testing activities and automating work flows. So repeatable, sustainable, cost-effective are the things that people absolutely have to have on their agendas for 2005 and 2006. Finally, the last point is migration. Don't

competencies to address these challenges. OpenPages works in alliance with leaders such as Deloitte, Ernst & Young, and PricewaterhouseCoopers to name a few. And we work to incorporate their methodologies and best practices for the benefit of our mutual clients. Second, readers should look



photo: David Toerger

"All of the effort of 404 will have little impact if it doesn't ultimately increase confidence among managers, board members, and investors who use and rely on financial statements."

— Eric Keller, CEO, Movaris

reinvent the wheel. Migrate the process you have to the sustainable, repeatable, and cost-effective environment.

KELLER: As painful as 404 has been for companies—and as painful as it will be to announce material weaknesses—the real objective is to avoid any circumstances that could require a restatement of financial statements. All of the effort of 404 will have little impact if it doesn't ultimately increase confidence among managers, board members, and investors who use and rely on financial statements. Companies must consider investing in advanced technology solutions as a way to achieve this increase in confidence.

Q: How can business decision makers be sure that their technology providers really understand the full scope of all the legal and financial challenges that they're facing with compliance?

DUFFY: We speak with decision makers every day about how they're finalizing their decision making. There are three areas that they look to for confidence in evaluating firms like ours. First, we recommend that readers ask their auditors which software vendors have the proper architectural and domain expertise and

for enterprise compliance providers that have close working relationships with complementary technology providers, in areas such as business intelligence solutions, so that their investment in complementary solution can leverage existing technology investments. Third, they should judge their software providers by looking for proven experience with global thought leader like that of our customers Viacom and Bristol Myers Squibb—ultimately, it's the word that has the greatest value.

Q: Let's consider the architectural level of the technology. What should executives be thinking about?

SAY: Our guidance to our customers is that they should try to consolidate

vergence of compliance management with performance management. These things shouldn't live separate lives. If compliance and performance management are integrated, and the compliance expectations are baked into performance management, compliance should be a by-product of good processes, done by good people, enabled by the right technologies.

Q: So looking forward, what should companies do next?

HAGERTY: Compliance is a fact of life. Trying to fight it is like tilting at windmills. Once you realize that you must meet this requirement, it can become part of the fabric of running your company. And when you start talking to people about how they really need to look at compliance across the board, there are three big things you need to think about. Compliance needs to be repeatable—that is, it's part of the process. It needs to be sustainable, which means it's going to be big enough to handle the permutations of every business challenge. And it

"Customers expect their enterprise software vendor to be the first line of defense in terms of addressing any compliance issue."

—Philip Say, director, solution marketing, my SAP ERP Financials, SAP



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"It's a challenge for companies to find enough of the right people. Look inside your organization to see what opportunities there are."

— Daniel B. Langer, CPA, CIA, CCSA, Jefferson Wells International

So that requires technology improvements to collaborate with people at the periphery of the business, who are close to the customer and close to the supplier.

Additionally, technology is driving new gains. I think technology, such as scorecarding, enables a focus on metrics that is important to achieve the strategic objectives of the business. Our customers are putting more focus here. And in the planning area, we're seeing people with a desire to capture some of the shadow systems—the systems that have a lot of management context but weren't brought into the overall performance management and compliance environment. And so technology is really being used to do all those things.

many tools into a single platform. We're suggesting that they look at their IT architecture like a Swiss army knife—meaning that it has to be multifunctional, it has to provide a great deal of utility regardless of the regulatory issue that they face, and they have to be able to apply it to any situation that may occur. And so it has to be open, it has to be flexible, it has to have multiple functions in terms of analytics, industry-specific processes, and addressing specific regulations. It also has to embed some process excellence around financial reporting, managing the supply chain and managing customer relationships. Don't carry a federation of different systems to address different compliance issues, but aggregate to get greater value out of the platform and drive down the IT costs for compliance.

Q: How can organizations start thinking about using the technology to take what's been an expense and turn it into a real opportunity for improvement?

KLEINHANS: The overwhelming initial opportunity is to remove the pain and reduce the tax on a business. We're clearly seeing that people are using technology and systems to do that. Compliance used to be a low-participation, finance-driven activity for a set number of people; now it's becoming a broad-use capability, and there's high participation across the organization.

Q: What about the human issues? How do they play into the SOX picture?

LANGER: It's a challenge for companies to find enough of the right people. Companies shouldn't be desperate. They should shop smartly and talk with lots of different parties that know what to look for in the partnerships that they're going to establish. The right people are out there. You just need a good due diligence process, and at the same time you should look inside your organization to see what opportunities there are. Because this is a great opportunity to bring people up to new roles of responsibility and create a better-matrixed organization to manage the performance of the business.

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Produced by The Custom Publishing Group, www.custpub.com

Written by Cheryl Krivda, cherylkrivda@custpub.com

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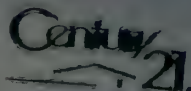


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COMMENTARY

BY JOSEPH WEBER

He Really Got Harley Roaring

CEO Jeffrey Bleustein is dismounting his hog after an exhilarating run

JEFFREY L. BLEUSTEIN KNOWS how to make an entrance. To deliver a 2002 commencement talk for engineering grads at Columbia University, the Harley-Davidson Inc. CEO roared out to the podium on a gleaming silver V-Rod, his company's newest rolling work of art. The Ivy Leaguers whooped, just as wowed as the black-jacketed, tattooed folk who have

long been bike fans. And they warmed even more to the Harley mantras Bleustein brought them: Charge headlong into life, he urged, with a sense of freedom and individual expression. "This is your chance to soar with the eagles," he said.

Now, Bleustein, 65, is heading for the open road. The brainy New Yorker, who earned a PhD in engineering at Columbia and later taught at Yale University before going into business, will leave Harley's corner office on Apr. 30. He will be remembered for having co-authored one of the great American comeback stories: vaulting the 102-year-old Milwaukee bikemaker from the financial junkyard—a near-bankruptcy experience—to roaring success.

When Bleustein arrived as engineering vice-president in 1975, Harley was notorious for shoddy workmanship. He and his colleagues restored quality and introduced new models, making biking appealing to weekenders while keeping an outlaw image. Today, Harley-labeled gear is a hit for grannies and babies as well as grizzled bikers. The machines sell to Wall Streeters as well as to Southern California gangs. With the newest Fat Boy starting at \$18,500, many Harleys go to the well-heeled, but you can still pick up something for \$6,500. For that reason, Bleustein resists the luxury label: "We've worked hard to keep it a brand for the people."

Plenty of execs have been lionized, only to prove all too mortal when their game plans fell apart. And much



The Best Performers

can still happen to dim the glow surrounding Bleustein, who became CEO seven years ago. (He will stay on as chairman but turns the job over to running Harley over to CFO Jamie Ziemer, 54.) It's not clear, for instance, whether his efforts to broaden Harley's appeal to women and young riders will pay off. Harley can't count on boomers forever. Its most loyal customers are in their late 40s or older—not far from the target group that buys Buicks.

But there's no doubt Bleustein & Co. have had an extraordinary run. For 19 years, Harley racked up unbroken gains in earnings and sales, hiking 2004 profits by 17%, to \$900 million and sales by 8.5%, to \$5.02 billion. That explains why it made the BusinessWeek 50 ranking of top-performing big companies for the past three years. Along the way, the share price has risen worth the equivalent of 39¢ back in late 1987, figuring in dividends and splits—have been lofted to more than \$60 today.

Just as important, Harley is a case study for marketers of how to freshen up a timeworn product. Sports-car makers and lifestyle producers should take note of the Harley Owners Group, clubs that let folks feed one another's rebel self-image while taking road trips and trading biking tips. Brewers could learn from Harley's moody print ads about how to turn products into personal statements. "It's a cult brand," says Northwestern University's Kellogg School of Management marketing professor Philip Kotler. "Every brand would love to be a cult brand."

Timing helped. In the post-feminism era, Harleys became a symbol for men to be men. Accountants could dress like James Dean on weekends. Harley softened the edges by backing

city runs and making riding look friendlier—but not too friendly. "You always need to keep a little bit of the outlaw in the brand," says the CEO.

Any brand built on motorcycle imagery has vulnerabilities. But Harley has shown a knack for adapting. Marketers should take some of Bleustein's ideas out for a spin—they've had a winning ride in Milwaukee. ■



WIDE APPEAL
Bleustein lured
execs and
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gangs

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One High-Stakes Card Game

Can cable TV's *World Poker Tour* keep making money at such a crowded table?

STEVE LIPSCOMB MAY not have ventured into TV poker with the strongest hand, but so far he's winning the jackpot. The former comic and lawyer did not invent the technique that lets viewers see players' cards. Nor did he forge a deal with the hottest TV network. Yet his *World Poker Tour* series, launched in March, 2003, has become a ratings smash on the Travel Channel and a trendsetter in the industry. His secret: turn poker into a slickly produced reality show. "It's dazzling, like you're on a movie set," says Antonio Esfandiari, 26, who won \$1.4 million in a WPT tournament last season. Viewers can follow the action, get close to the wacky characters populating poker rooms, and pick up tips. "We set out to capture the drama," says Lipscomb.

How long will Lipscomb's hot streak last? The buoyant 43-year-old founder and his partner, Minnetonka (Minn.) casino operator Lakes Entertainment Inc., took WPT Enterprises Inc. public last August, and the stock has almost tripled. The success of the series, which launched its third season on Mar. 2, has also spawned numerous competitors at networks such as ESPN and NBC that boast greater reach and cachet than the Travel Channel. That makes it tougher for WPT to maintain its dominance. No wonder Lipscomb is racing to move beyond WPT's TV deal—worth \$10 million to \$12 million a year—to make money from greater global distribution, online betting,



a new *Professional Poker Tour* series, and licensing deals.

After all, now is the time to make multiple bets on the game. It's hot with college kids and celebrities and is the fastest-growing segment of the \$10 billion Internet gambling industry. Advertisers seem to be getting comfortable with gambling shows: "Poker has become good fun entertainment," says Peter McLoughlin, a spokesman for Anheuser-Busch Cos.

THE STAT

57

The number of countries where *World Poker Tour* shows can be seen abroad

Few are more convinced of poker's potential than Lipscomb, an ambitious middle child from Knoxville, Tenn., whose Southern Baptist grandmother taught him the finer points of the game at age 8. He has already sold the show into 57 countries and hopes to reach 200 in the next few years. The company is licensing everything

from playing cards and \$500 poker to slot and video poker machines. Bigger bets come in the next few months when WPT will move into online gaming with offshore partner WagerWorld, part to work around government regulations. WPT Chief Financial Officer Steele says the business "has the potential to be critical to our revenues."

\$70 MILLION IN PRIZES

LIPSCOMB RECOGNIZES that 2005 is the year that WPT has to prove it's not just lucky but, as he puts it, "real and sustainable." To start, he needs to keep ramping up revenues. On Mar. 8, WPT posted first-year earnings of \$752,000 on sales of \$17.6 million, compared with a loss

of \$493,000 on sales of \$4.3 million in 2003. Those results may not seem like much, but Nick Danna of Birmingham (Ala.) brokerage Sterne, Agee & Leach Inc. has a buy rating on the stock because he thinks 2004 is the first chapter of what's likely to be a lucrative market. "This is the corner of the poker," says Danna. Lipscomb is trying to stack the deck this season, with

a prize pool of more than \$70 million, as well as flashier sets and graphics.

But the table is getting crowded. Among the shows competing for eyeballs are Bravo's *Celebrity Poker Showdown*; *Enter Superstars* on Fox Sports Network; GSN's *Poker Royale: Battle of the Sexes*; the *National Heads-Up Poker Championship* on NBC. Then there are start-ups such as Casino & Gaming Television. The biggest threat is ESPN, which airs the popular *World Series of Poker*. It's expanding coverage and even has a fictional poker series, *Tilt*.

For Lipscomb, the Holy Grail is to have WPT become what the NBA and PGA are to their sports—the gold standard for players and viewers who care about the game. With an estimated 50 million poker players in the U.S. alone, it's likely that TV poker is here to stay. But Lipscomb and his *World Poker Tour* have a way to go before they convert some big pots into a straight-flush global franchise. ■

—By Diane Brady in New York



PLAINTIFF
Some female
workers say
they're paid
less than men

Wal-Mart Vs. Class Actions

The retail giant's novel defense in a massive suit could rewrite the playbook

CORPORATE AMERICA could find it a whole lot easier to fight off employment class actions if Wal-Mart Stores Inc. prevails in a sex discrimination case to be heard soon by the U.S. Ninth Circuit Court of Appeals. Indeed, a Wal-Mart victory could tilt the playing field for virtually all of these kinds of suits, which have plagued Boeing, Coca-Cola, and dozens of other large employers over the years. Wal-Mart's ambitious legal strategy strikes at the heart of what it means to file a class action. The company maintains that its constitutional rights would be violated if the court allows a suit to go for-

ward involving up to 1.5 million of the retailing giant's current and former female employees (table, page 78). Because such a case would deprive the company of its rights to defend itself against each woman's claim, it argues, the courts should allow suits only on a store-by-store basis. If the Ninth Circuit agrees and strikes down the multistate action certified by a lower court, it would likely kill the largest employment class action in U.S. history. More broadly, it would open wide the door for all large companies to make similar arguments. "A victory for Wal-Mart might mean that plaintiffs can't bring nationwide class actions anymore and that they might have to do them locally or regionally," says Mark S.

"WHAT COULD MAKE THE EUROPEAN CEO OF ONE OF THE WORLD'S LARGEST COMPANIES ADMIT TO AN ATTRACTION FOR FRANCE?"

Nani Beccalli explains why GE can't do without French high-tech.

Dichter, a management-side employment lawyer at Morgan, Lewis & Bockius LLP.

Wal-Mart's case is no slam dunk. A few companies have tried similar arguments in bits and pieces and gotten nowhere. But Wal-Mart is the first to tackle the constitutional issues head-on, say Dichter and other experts. Certainly, it faces tough odds at the Ninth Circuit, one of the nation's more liberal federal appeals courts. Instead, it's probably aiming for the more conservative U.S. Supreme Court, say experts. At the same time, Wal-Mart has been hedging its bets by engaging in settlement talks with the plaintiffs for several months, say lawyers involved.

COURT-CLOGGER?

STILL, THE QUESTION is whether Wal-Mart's suggested store-by-store alternative makes sense. After all, the most extreme outcome—thousands of mini class actions—would clog the U.S. courts for years. Even the company's own prediction that plaintiffs could have grounds to bring discrimination claims at no more than 10% of its 3,400 U.S. stores would qualify as a lawyer's full-employment act.

status, allowing them to sue on behalf of all women who had worked at Wal-Mart's U.S. stores since December, 1998. Wal-Mart quickly appealed the class certification to the Ninth Circuit, which is due to set the hearing date any day.

The thrust of Wal-Mart's appeal is that the district judge ran roughshod over the company's constitutional rights to due process and to a jury trial. Despite the company's reputation for micromanaging down to the penny, it argued that pay and promotion decisions are made almost entirely by local store managers. So the judge should have ignored the plaintiffs' statistics showing large nationwide disparities in the way female employees are paid and promoted. Instead, it should hear only store-level suits.

Doing otherwise, the company says, would leave it unable to prove that an individual was paid correctly or properly

THE STAT

93%

Women's share of Wal-Mart cashier jobs, the company's lowest wage category

Data: Legal Affairs

employees together in lawsuit is to deal with complaints that are in common. In employment discrimination cases, the problems usually involve disparate policies or practices by the corporation. Indeed, the plaintiffs' response is a broad workforce data actually more relevant than individual hearings in such cases. They point out, for example, that

retailer promoted hourly workers using a "tap-on-the-shoulder" method, which employees couldn't apply for promotion and store managers single out promising candidates when vacancies occurred. So it would be impossible to tell now which individual women would have qualified for a promotion even if there had been no discrimination. In these circumstances, the use of workforce data to compute aggregate monetary relief "has more basis in reality... than an individual-by-individual approach," the plaintiffs say, citing a prominent 1974 class action.

The two sides disagree just as strongly about which approach would be fair to the individual women involved. The court uses aggregate company statistics as is typical in such cases, then women who never had any desire to become managers could get back pay or damages they're not entitled to, points John Beisner, a class action attorney with O'Melveny & Myers LLP who filed an amicus brief supporting Wal-Mart on behalf of the U.S. Chamber of Commerce. Or those who suffered egregious discrimination at one store would get nothing if Wal-Mart wins. "That's the plaintiff's choice you get when you hear these giant cases," he says.

The plaintiffs argue that rough justice is better than no justice at all. They say that in the nationwide class approach, Wal-Mart's total liability would be seen by looking at how all female employees fared across the company. If some of that money went to women who didn't actually suffer, then women who did experience discrimination might get less than they should have. But Wal-Mart itself would no worse off.

Wal-Mart's sheer size puts it in a category all its own. If it succeeds in cutting class actions down to bite-size pieces, large—and not so large—employers could end up benefiting. ■

—By Aaron Bernstein in Washington

Do Constitutional Rights Trump **Class Actions?**

Mounting an ambitious defense, Wal-Mart argues that the U.S. Constitution invalidates a federal district court ruling giving its current and former 1.5 million female employees across its 3,400 stores the right to bring a sex-discrimination class action against the retailer. What the company says in its appeal:

DUE PROCESS The Fifth Amendment gives Wal-Mart a "basic due process right" to offer a defense against each individual plaintiff's claim of discrimination

JURY TRIAL The Seventh Amendment gives the company the right to have a jury hear its defense of its conduct regarding each plaintiff before punitive damages are awarded

INDIVIDUAL STORE TRIALS Plaintiffs should be able to file class actions only at individual Wal-Mart stores, which would create classes of 500 to 1,000 women

Data: Legal Affairs

Of course, Wal-Mart may simply believe that few store-level cases would be filed in the end, although Wal-Mart's lawyers deny that. Still, "if even 100 suits were brought, it would be a mess for Wal-Mart," warns Joseph M. Sellers, a partner at Cohen, Milstein, Hausfeld & Toll who represents the plaintiffs.

The case began in 2001, when a group of female Wal-Mart employees sued, claiming that the world's largest retailer systematically paid women less than men in the same jobs and promoted men ahead of similarly talented women. Last June a Northern California District Court judge granted the plaintiffs class

passed over for promotion. So it could be forced to pay for something it didn't do. That would be a clear violation of the Fifth Amendment's requirement that "no person shall be... deprived of life, liberty, or property without due process of law." Says Theodore J. Boutros Jr., a Wal-Mart lawyer at Gibson, Dunn & Crutcher LLP: "When you're talking about taking money from one citizen and giving it to another, you can't just rely on aggregate statistics, which don't tell you who is actually discriminated against."

The problem, of course, is that this logic undercuts the very concept of class actions. The point of grouping many em-

GE's European CEO Nani Beccalli says France has a talent for innovation.

GE is as American as apple pie. What's it like doing business with the French?

Firstly, GE today is a truly global company with a long history in Europe. Secondly, there is a way of doing business which France and the United States have in common. Just look at our 50/50 joint venture with SNECMA producing jet engines in France [CFM International]. It's an outstanding and extremely successful partnership. It has existed for 30 years and will probably be around for 30 more. We've become so intimate, we can't do without each other.

What qualities does France have to offer?

The French have a passion for engineering and technology, for research and solutions that push back the boundaries. The Ecole Polytechnique is one of the best engineering schools in the world and French technology tends to be very sophisticated. I'm a car fanatic, and I can still remember when the Citroën DS was introduced in the mid 50s. It was incredibly advanced, way ahead of its time.

Has France kept that edge?

Unlike most other countries, France hasn't given up any particular element of its technology. A lot of European countries have either limited or even non-existent portfolios of technology products. France is different. They still have a pharmaceutical industry, aviation, space, a helicopter industry, a train industry...

GE in France

- Established in France for more than 50 years
- 4,800 employees, 3 R&D centers, 6 production sites
- GE's partnership with SNECMA gave them a lead in the aircraft engines industry

the technology center for our medical business. The French are very creative. They have a great capacity for dreaming and they're not afraid to launch large-scale projects. TGV is a perfect example.

The French also value tradition. Does that make them conservative?

Not at all. Respect for tradition doesn't mean you're afraid of change. I've brought my fair share of change to GE, but I have tremendous respect for tradition. You can tell by the way I dress. I'd say France strikes the right balance between tradition and innovation.

Does that make it attractive for a foreign investor?

Yes it does, especially if you're trying to make a technological product. In France, GE has one of the world's most technologically advanced units for producing turbines as well as



"The French have a passion for engineering and technology, for research and solutions that push back the boundaries."

GE is a major player in financial services. How do you rate France in that department?

France is an advanced and sophisticated country from every point of view. In an environment like that, it's natural for financial services to be thriving. There are 60 million consumers in France. That's a rich community of people that has to save money, spend money, buy houses, buy cars, take out mortgages and borrow.

Would you live there?

Absolutely. Paris is my favorite city. I'm Italian, but I prefer Paris to Rome by a factor of 100. Paris is a place which combines tradition with modernity.

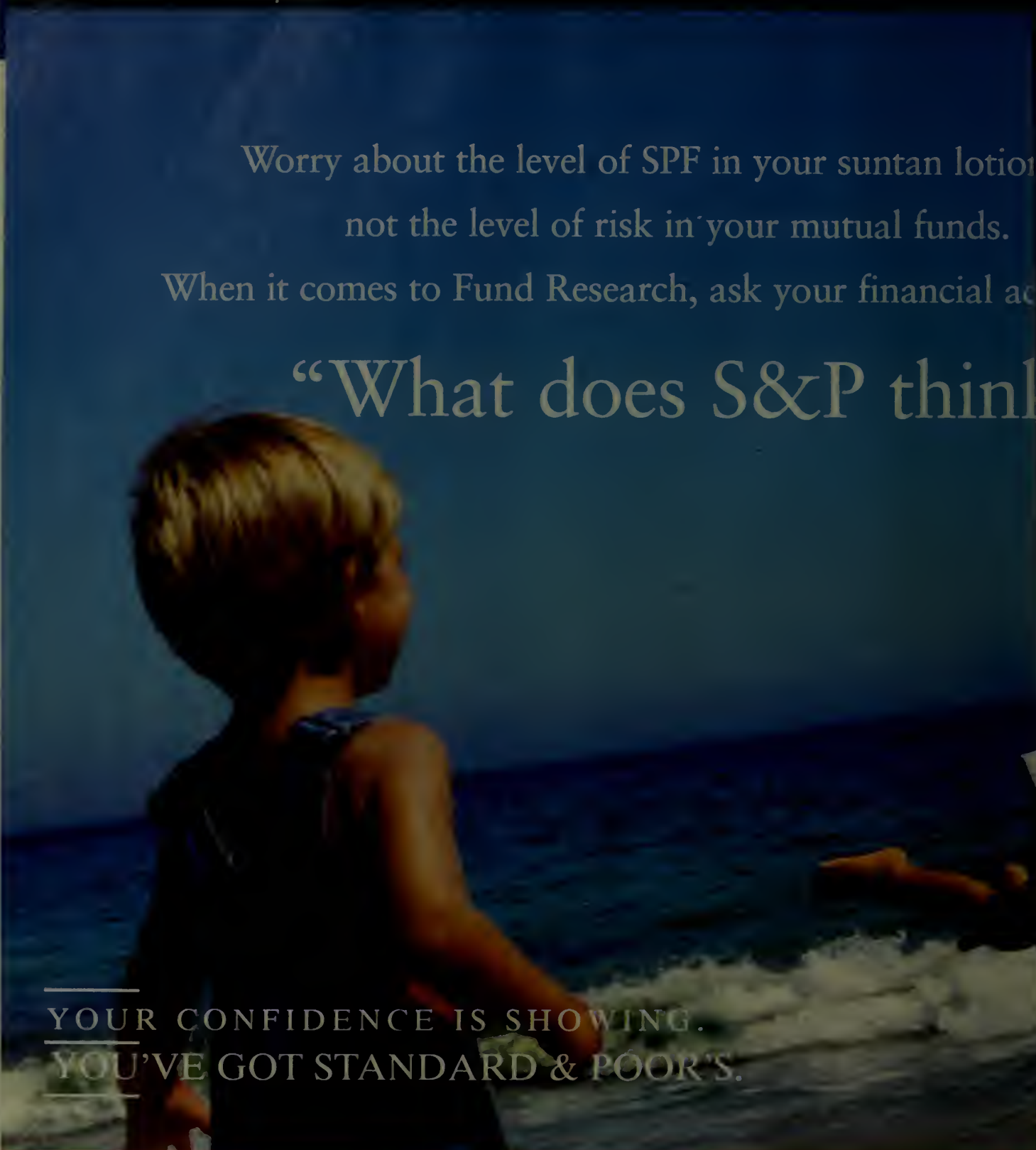
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'I Can't Wait To Compete...'

As Symantec's chief finalizes his deal for Veritas, war with Microsoft looms

ONCE JOHN W. Thompson sets a goal for himself, there isn't much that can deter him. On Nov. 5, the chief executive of security software giant Symantec Corp. was scheduled to make the presentation of his career, a pitch to the directors of Veritas Software Corp. on a takeover by his company that would be the largest software merger ever. He had arranged previously to have minor surgery that morning. But instead of the local anesthetic he was expecting, he was completely knocked out for the procedure. Still, after waking up in a fog at 10 a.m., he shook off the cobwebs and nailed his performance just three hours later. "A lot of other CEOs would have canceled. He didn't hesitate," says Gary Bloom, Veritas' chief executive. Thompson won the board's approval for the deal a few weeks later.

Thompson will need all the determination he can muster to face down the challenges ahead for Symantec. The 55-year-old is trying to complete the \$13 billion Veritas merger in the face of Wall Street opposition, at the same time he's preparing Symantec for what's shaping up to be an all-out war with fearsome Microsoft Corp. Wall Street analysts question the usefulness of pairing the leader in consumer and corporate security software with the leader in information storage software. Symantec's stock plunged 32%, to \$23, in the week after the deal was announced in December. Rather than second-guessing himself, though, Thompson is forging ahead.

Thompson is building a powerhouse just as Gates enters the antivirus biz

"I'm not going to let Wall Street dictate or set the strategy for our company, I'm going to set the strategy," he says.

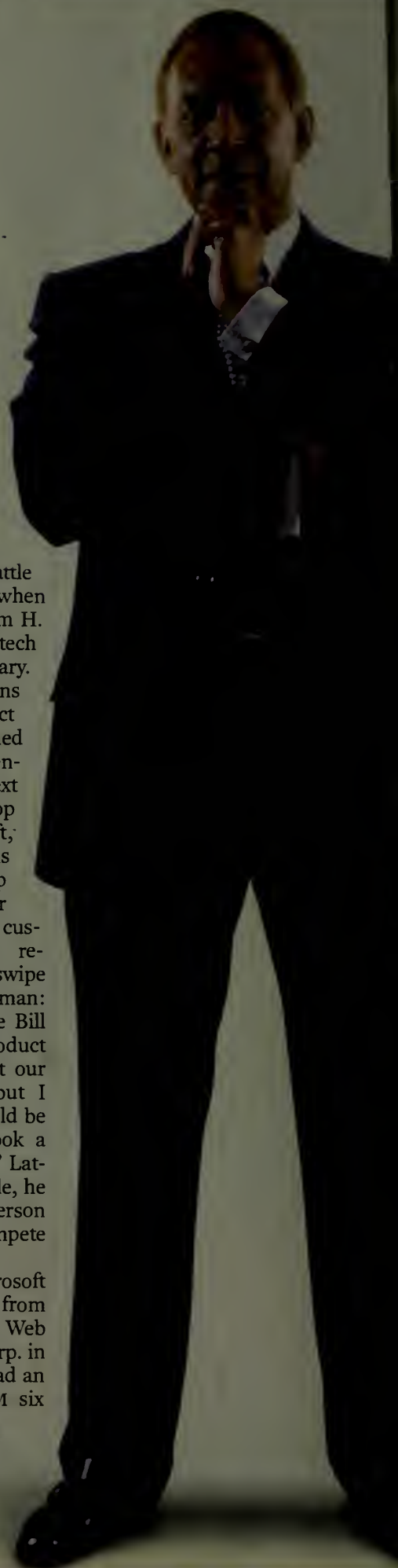
He isn't shying away from the battle with Microsoft, either. Sparks flew when he and Microsoft Chairman William H. Gates III took turns speaking at the tech industry's RSA Conference in February. Gates explained that Microsoft plans to deliver its first antivirus product this year, a subscription service aimed at consumers. Analysts expect it to enter the corporate security market next year. Gates called security "the top

priority for Microsoft; the top priority in terms of our R&D, and the top priority in terms of our communications with customers." Thompson responded by taking a swipe at the world's richest man: "I could try to be like Bill and show you product demos and talk about our product road map, but I thought our time would be better spent if we took a

more strategic view of what we do." Later, pressed about the brewing battle, he said: "I am the most competitive person in the world, and I can't wait to compete against Microsoft."

What's that, a death wish? Microsoft has decimated a long line of rivals, from Netscape Communications Corp. in Web browsers to Lotus Development Corp. in spreadsheets. Yet Thompson has had an astonishing run since he left IBM six years ago to take over Symantec. He sold off tangential products and fleshed out the portfolio with more

THOMPSON: He battled Microsoft at IBM



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than 20 acquisitions to build a suite of security products for businesses. When the computer virus plague hit in 1994, Symantec was ready, and its revenue surged more than 30% per year for the past two years. Meanwhile, chief rival McAfee Inc. overextended and ran into trouble. Symantec's stock has soared 1000% in six years—to a peak of \$300 before the merger news broke.

Thompson has at least a fighting chance of overcoming his challenge of creating a new powerhouse in the software industry. Sure, it will be brutal in the consumer antivirus business, where Microsoft could wreak havoc by undercutting Symantec on price. But if Thompson integrates Veritas effectively, he might be able to prove his critics wrong. For starters, the merger makes Symantec more diversified and less vulnerable to Microsoft's move into security. But that, by combining the two, this gives Symantec the heft it needs to be seen by corporate executives as a strategic partner they can depend on for a wide variety of important products. "If anyone can integrate and make a success out of this acquisition, Thompson can do it," says John S. Maxwell, senior vice-president of TCW Group Inc., Symantec's third-largest shareholder.

Thompson's goal is to redefine the way corporate leaders think about security and information storage. His idea is that as companies become ever more dependent on networks, the two markets will converge. He calls it the information integrity market. He plans on offering a broad portfolio of interlocking products that handle everything from antivirus to intrusion protection to data backup to storage network management. The

John Thompson's To-Do List

CEO Thompson has built Symantec into the leading player in antivirus software over the past six years. That franchise is now under threat. Here's what he has to do to make his way through the coming

Bill Townsend, 62, Semi-retired pediatrician. Transitioning practice to daughter. Beth. Starting to enjoy investment income. Recently purchased lakeside cottage where he'll teach his six granddaughters to fish.

People like Bill are the reason
for an investment firm like ours.

RAYMOND JAMES



At IBM he had helped position the software unit to move from laggard to the leader it has become. His main contribution, in the mid-1990s, was persuading makers of corporate software to design their products to work with IBM's middleware. Before that, many tech companies were beginning to focus almost exclusively on Microsoft's software. "He's battle-tested for what he's doing now," says John M. Thompson, former IBM vice-chairman and Thompson's boss in the mid-'90s.

Make no mistake, though: Microsoft's incursion is a serious threat. It will be able to use its Windows monopoly to get its antivirus software loaded onto nearly every consumer PC. Microsoft hasn't revealed its pricing plans, but

hopes that by the time Microsoft starts selling corporate security software, Symantec have redefined the market and Microsoft, which doesn't have storage software, won't be able to compete effectively with him.

Thompson is well prepared to duke it out with Microsoft. Raised in a working-class black family in segregated Florida, he was never discouraged by challenges or fights. Just the opposite. After he became one of the first in his high school to wear an afro, one of the administrators tried to publicly humiliate him. "He said I was nothing more than a thug and I would never amount to anything," recalls Thompson. He resolved to prove the guy wrong. His relentless drive propelled him into an impressive 25-year career at IBM, where he rose to run the then-\$37 billion North American sales region.

GATES'S AGENDA

He now calls security Microsoft's "top priority"

if it undercuts Symantec's \$24.95-per-year subscription price, it will likely gain substantial market share. And if it gives away the software—though, that's unlikely because of antitrust issues—it could quickly erode the market for Symantec and others. Symantec gets about 40% of its \$2.6 billion in revenues from consumer antivirus products, making it far and away the largest player.

In the corporate world, Symantec has distinct advantages. Corporations look for software packages that cut across several operating systems. Because of Microsoft's exclusive focus on Windows, it won't offer a comprehensive package like Symantec does. So Symantec is likely to remain the go-to supplier for many customers who are deeply skeptical of Microsoft's ability to address the virus plague. "There are just too many bad experiences," says David Jordan, the chief information security officer for Arlington County in Virginia, a Symantec customer.

Experts figure Thompson has about one year to make his strategy work and gird for Microsoft. He's uncharacteristically curt when asked about Microsoft at press events and rolls his eyes when reporters bring it up. "How many times can I answer the question, 'How are you going to compete against Microsoft?'" he asks. He'd better get used to it. From now on, that battle will define both Symantec's future and his legacy. ■

—By Sarah Lacy in San Mateo, Calif., with Steve Hamm in New York

MICROSOFT AT BAY The software giant is entering Symantec's security software market this year. Thompson has to limit the threat to his consumer antivirus business and force Microsoft in the corporate market.

THE VERITAS MERGER WORK

Thompson has to pull off his \$13 billion merger of the storage software giant in the face of investor opposition. Then he has to blend the two companies' diverse businesses into a unified package that appeals to tech buyers.

A NEW GROUP OF INVESTORS The merger will slow Symantec's torrid 30% revenue growth. Thompson must draw in investors who believe that over the long run a more diversified Symantec will be a more valuable company.

Retiring early.

Caring for two generations

Saving for twins' college.

Opening a coffee house

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EDITED BY JOHN CAREY

INNOVATIONS

Worm poop' and phylactic yuks

Producing waste rich in nitrogen, earthworms have long been considered friends of the green-thumb set. Now TerraCycle, a Trenton (N.J.) startup, has developed a way to mass-produce what its founder, a Princeton University dropout, bills as "worm poop" plant food. Coffee grounds, beer dregs, and other organic remains are mixed, then fed to millions of worms on TerraCycle's payroll. The voracious invertebrates produce waste that is packaged in recycled soda



bottles. TerraCycle's product is now on the shelves of 254 Wal-Mart stores, considered training ground for its 3,500 U.S. stores.

Laughter might indeed be the best medicine. After showing subjects scenes from funny movies and disturbing images, such as *Kingpin* and *Private Ryan*, researchers at the University of Maryland School of Medicine found that laughing caused the lining of blood vessels to dilate or expand, increasing blood flow an average of 22%. Distressing scenes led to constriction, reducing the flow by 35%. This supports theories about a link between stress and poor cardiovascular health—and suggests regular rib-tickling helps counter the effects.

—Rod Kurtz



SORE EYES
Glaucoma affects the optic nerve's fibers (below)

REGENERATION CAN FRAYED NERVES BE FORTIFIED?

UNLIKE MANY BODY tissues, nerve cells and fibers in the central nervous system cannot regenerate. That's why glaucoma causes blindness and severe spinal cord injuries result in paralysis. But can this biological limitation be lifted? Perhaps.

In what they call "a dream becoming reality," researchers at the Harvard-affiliated Schepens Eye Research Institute have successfully used genetic manipulation to regenerate damaged optic nerves—running from the eyes to the brain—in laboratory mice.

The Schepens team removed proteins that help prevent regeneration in mammals. These protein blockers may be evolution's way to make sure that memory and behavior are not continuously erased. (Frogs, by contrast, can regenerate nerves—meaning their memories are probably not too sharp.)

The next step is to determine whether the new nerves actually restore vision in the mice. Eventually, researchers hope to help humans with nerve damage to see and walk again.

—Rod Kurtz

ALARMS A WHIFF OF DETECTION IS WORTH...

A DEVICE AS SMALL as a paperback book may be able to sniff out both dirty bombs and bioterrorism attacks. Funded by \$10 million from the Defense Dept., CombiMatrix hopes to begin rolling out such a system later this year. The product contains a computer chip that can sense up to 20 different threats, from biological agents like anthrax

to deadly chemicals and radiation. The chip houses 12,000 tiny wells, each of which is designed to root out different harmful agents, using electrical signals that can be read from remote locations.

CombiMatrix hopes to deliver test units to the military, for soldiers to use on the battlefield, by the end of the year. Ultimately the Defense Dept. hopes that similar devices can be installed in airports, malls, sports arenas, and other public spaces.

—Arlene Weintraub

SPORTS

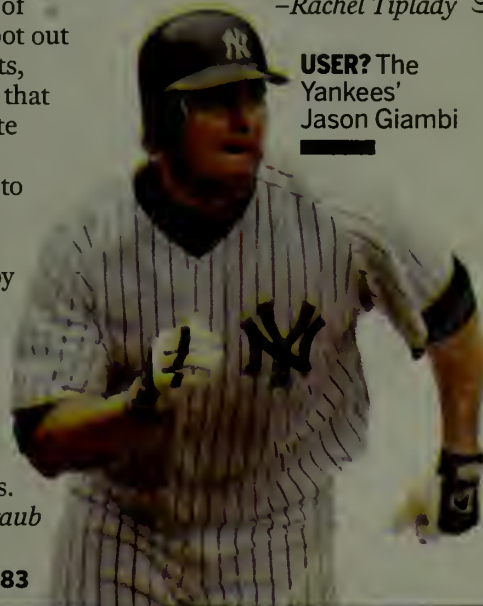
THIS STEROID SLEUTH DOESN'T QUIT

ATHLETES WHO ARE tempted to cheat, be warned: Scientists at the University of Nottingham are devising an ultraprecise test for performance-enhancing drugs that could pinpoint even the most inconspicuous banned steroids lurking in the body. By adapting a technique called hydroxylation, widely used in oil exploration, Professor Colin Snape and his team believe they can nail the identity of any carbon-based molecules. The results were published in the Feb. 15 issue of *Rapid Communications in Mass Spectrometry*.

It's possible to spot drugs in the body because they have a different carbon isotope ratio than naturally produced substances. But testing can be tricky, as a lot of these molecules are "sticky," or hard to strip down. Some current methods work by adding carbon to the target molecule, which can skew results. "Hydroxylation leaves the carbon skeleton intact, opening up the body to intense scrutiny," says Snape, who hopes his work can eventually be used for a wide range of sports. Perhaps the new method will be ready in time for the 2012 Olympics.

—Rachel Tiplady

USER? The Yankees' Jason Giambi



(CLOCKWISE FROM L TO R) VALERIE GILES/PHOTO RESEARCHERS INC.; BARBARA GALATI/PHOTOTAKE; EZRA SHAW/GETTY IMAGES

SPECIAL REPORT

OUTSOURCING

First came manufacturing. Now companies are farming out R&D to cut costs and get new products to market faster. Are they going too far?

**BY PETE ENGARDIO
AND BRUCE EINHORN**

PHOTOGRAPHY BY
DAVID HARRINGTON/GETTY IMAGES

HTC'S CHOU

The supplier of choice to
smart phone providers

ING

INNOVATION





BANGALORE The Electronic City in Bangalore, India, is a hub for technology companies.

AS THE MEDITERRANEAN SUN BATHED THE FESTIVE cafés and shops of the Côte d'Azur town of Cannes, banners with the logos of Motorola, Royal Philips Electronics, palmOne, and Samsung fluttered from the masts of plush yachts moored in the harbor. On board, top execs hosted nonstop sales meetings during the day and champagne dinners at night to push their latest wireless gadgets. Outside the city's convention hall, carnival barkers, clowns on stilts, and vivacious models with bright red wigs lured passersby into flashy exhibits. For anyone in the telecom industry wanting to shout their achievements to the world, there was no more glamorous spot than the sprawling 3GSM World Congress in Southern France in February.

Yet many of the most intriguing product launches in Cannes took place far from the limelight. HTC Corp., a red-hot developer of multimedia handsets, didn't even have its own booth. Instead, the Taiwanese company showed off its latest wireless devices alongside partners that sell HTC's models under their own brand names. Flextronics Corp. demonstrated several concept phones exclusively behind closed doors. And Cellon International rented a discrete three-room apartment across from the convention center to unveil its new devices to a steady stream of telecom executives. The new offerings included the C8000, featuring eye-popping software. Cradle the device to your ear and it goes into telephone mode. Peer through the viewfinder and it automatically shifts into camera mode. Hold the end of the device to your eye and it morphs into a videocam.

HTC? Flextronics? Cellon? There's a good reason these are hardly household names. The multimedia devices produced from their prototypes will end up on retail shelves under the brands of companies that don't want you to know who designs

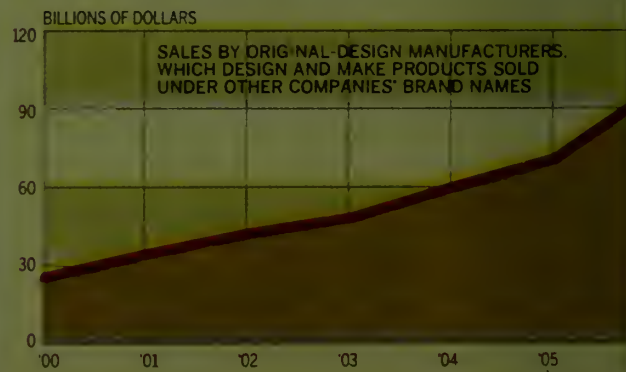
their products. Yet these and other little-known companies with names such as Quanta Computer, Premier Imaging, Technologies, and Compal Electronics, are fast emerging hidden powers of the technology industry.

They are the vanguard of the next step in outsourcing—innovation itself. When Western corporations began selling factories and farming out manufacturing in the '80s and '90s to boost efficiency and focus their energies, most insisted that important research and development would remain in-house.

But that pledge is now passé. Today, the likes of Dell, Motorola, and Philips are buying complete designs of some of their devices from Asian developers, tweaking them to their specifications, and slapping on their own brand names. I

THE NEW NOT-INVENTED

Companies are farming out the design of more new



Data: Technology Forecasters Inc.

cell phones. Asian contract manufacturers and independent design houses have become forces in nearly every tech device, from laptops and high-definition TVs to MP3 music players and digital cameras. "Customers used to participate in design two or three years back," says Jack Hsieh, vice-president of finance at Taiwan's Premier Imaging Technology Corp., a major supplier of digital cameras to leading U.S. and Japanese firms. "But starting last year, many just take our product. Because of price competition, they have to."

While the electronics sector is furthest down this road, the search for offshore help with innovation is spreading to nearly every corner of the economy. On Feb. 8, Boeing Co. said it is working with India's HCL Technologies to co-develop software for everything from the navigation systems and landing gear to cockpit controls for its upcoming 7E7 Dreamliner jet. Pharmaceutical giants such as GlaxoSmithKline and Eli Lilly are teaming up with Asian biotech research companies in a bid to cut the average \$500 million cost of bringing a new drug to market. And Procter & Gamble Co. says it wants half of its new product ideas to be generated from outside by 2010, compared with 20% now.

Competitive Dangers

UNDERLYING THIS TREND is a growing consensus that more innovation is vital—but that current R&D spending isn't yielding enough bang for the buck. After spending years squeezing costs out of the factory floor, back office, and warehouse, CEOs are asking tough questions about their once-cloistered R&D operations: Why are so few hit products making it out of the labs to the market? How many of those pricey engineers are really creating game-changing products or technology breakthroughs? "R&D is the biggest single remaining controllable expense to work on," says Allen J. Delattre, head of Accenture U.S.'s high-tech consulting practice. "Companies either will have to cut costs or increase R&D productivity."

The result is a rethinking of the structure of the modern corporation. What, specifically, has to be done in-house anymore? At a minimum, most leading Western companies are turning outward a new model of innovation, one that employs global networks of partners. These can include U.S. chipmakers, Taiwanese engineers, Indian software developers, and Chinese factories. IBM is even offering the smarts of its famed research labs

CEOs ARE RETHINKING THEIR R&D OPERATIONS, WONDERING WHERE MISSION-CRITICAL RESEARCH ENDS AND COMMODITY WORK BEGINS

and a new global team of 1,200 engineers to help customers develop future products using next-generation technologies. When the whole chain works in sync, there can be a dramatic leap in the speed and efficiency of product development.

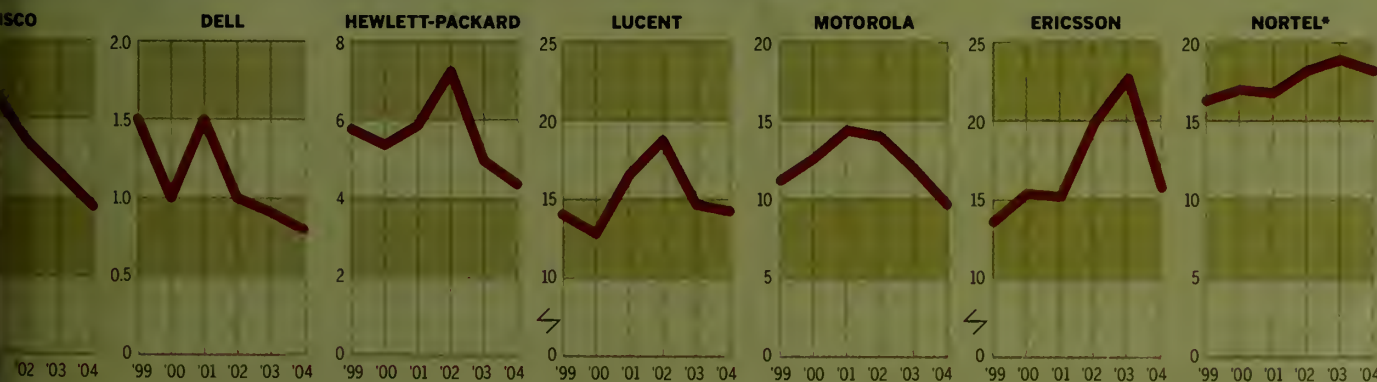
The downside of getting the balance wrong, however, can be steep. Start with the danger of fostering new competitors. Motorola hired Taiwan's BenQ Corp. to design and manufacture millions of mobile phones. But then BenQ began selling phones last year in the prized China market under its own brand. That prompted Motorola to pull its contract. Another risk is that brand-name companies will lose the incentive to keep investing in new technology. "It is a slippery slope," says Boston Consulting Group Senior Vice-President Jim Andrew. "If the innovation starts residing in the suppliers, you could incrementalize yourself to the point where there isn't much left."

Such perceptions are a big reason even companies that outsource heavily refuse to discuss what hardware designs they buy from whom and impose strict confidentiality on suppliers. "It is still taboo to talk openly about outsourced design," says Forrester Research Inc. consultant Navi Radjou, an expert on corporate innovation.

The concerns also explain why different companies are adopting widely varying approaches to this new paradigm. Dell, for example, does little of its own design for notebook PCs, digital TVs, or other products. Hewlett-Packard Co. says it contributes key technology and at least some design input to all its products but relies on outside partners to co-develop everything from servers to printers. Motorola buys complete designs for its cheapest phones but controls all of the development of high-end handsets like its hot-selling Razr. The key, execs say, is to guard some sustainable competitive advantage, whether it's control over the latest technologies, the look and feel of new products, or the customer relationship. "You have to draw a line," says Motorola CEO

PROLOGUE

Research and development budgets account for a smaller percentage of sales



by & Poor's CompuServe

*AS OF JUNE 30, 2004. FULL YEAR NOT YET REPORTED

SPECIAL REPORT

Edward J. Zander. At Motorola, "core intellectual property is above it, and commodity technology is below."

Wherever companies draw the line, there's no question that the demarcation between mission-critical R&D and commodity work is sliding year by year. The implications for the global economy are immense. Countries such as India and China, where wages remain low and new engineering graduates are abundant, likely will continue to be the biggest gainers in tech employment and become increasingly important suppliers of intellectual property. Some analysts even see a new global division of labor emerging: The rich West will focus on the highest levels of product creation, and all the jobs of turning concepts into actual products or services can be shipped out. Consultant Daniel H. Pink, author of the new book *A Whole New Mind*, argues that the "left brain" intellectual tasks that "are routine, computer-like, and can be boiled down to a spec sheet are migrating to where it is cheaper, thanks to Asia's rising economies and the miracle of cyberspace." The U.S. will remain strong in "right brain" work that entails "artistry, creativity, and empathy with the customer that requires being physically close to the market."

You can see this great divide already taking shape in global electronics. The process started in the 1990s when Taiwan emerged as the capital of PC design, largely because the critical technology was standardized, on Microsoft Corp.'s operating system software and Intel Corp.'s microprocessor. Today, Taiwanese "original-design manufacturers" (ODMs), so named



EYE ON THE PRIZE

Marks has moved Flextronics into design because they design and assemble products for others, supplying 65% of the world's

notebook PCs. Quanta Computer alone expects to churn out 16 million notebook PCs this year in 50 different models for buyers that include Dell Computer, and Sony.

Now, Taiwanese ODMs and other side designers are forces in nearly every digital device on the market. Of the 100 million mobile phones expected to be sold worldwide this year, up to 20% will be the work of ODMs, estimates says analyst Adam Pick of the El Segundo (Calif.) market research firm iStrategy Corp. About 30% of digital cameras produced by ODMs, 65% of MP3 players, and roughly 70% of personal digital assistants (PDAs). Building on their experience with PCs, they're increasingly creating recipes for their own gizmos, blending the latest advances in

chips, specialized software, and state-of-the-art digital components. "There is a lot of great capability that has grown in Taiwan to develop complete products," says Doug Rasor, worldwide strategic marketing manager at chipmaker Texas Instruments Inc. TI often supplies core chips, along with rudimentary designs, and the ODMs take it from there. "They can do the system integration, the plastics, the industrial design, and the cost manufacturing, and they are happy to put Dell's name on it. That is a megatrend in the industry," says Rasor.

Taiwan's ODMs clearly don't regard themselves as mere

A MATTER OF DESIGN

Technology companies in the U.S. have long hired manufacturers in Taiwan and other countries to make their products. Now an increasing number of tech products are being designed offshore, too.

PDAs	NOTEBOOK PCs	DIGITAL CAMERAS	MOBILE PHONES	NETWORKING EQUIPMENT
DESIGNS OUTSOURCED: 70%	DESIGNS OUTSOURCED: 65%	DESIGNS OUTSOURCED: 30%	DESIGNS OUTSOURCED: 20%	DESIGNS OUTSOURCED: Nascent
 Personal digital assistants (PDAs) and pocket PCs use many evolving technologies. So even big brands like Hewlett-Packard and palmOne collaborate with Asian suppliers on design. Other brands use their vendors' platforms.	 Taiwanese companies design and manufacture most laptops sold worldwide. They also control many patents for industrial and mechanical design. Dell, Hewlett-Packard, Sony, and even Apple use designs by contract manufacturers.	 Top brands like Nikon and Canon design most of their own cameras but now buy cheaper models from Taiwanese vendors to get into the market quickly. HP and Kodak collaborate closely on design with Asian manufacturers.	 Handsets by second-tier brands like Phillips and Siemens and operators like T-Mobile and AT&T Wireless are based on designs by outside firms. Motorola, Nokia, Sony-Ericsson and others farm out design of low-end models.	 Communications equipment giants like Cisco, Lucent, and Nortel design complex switches and routers in-house. But they're having outsiders design more low-end gear and develop key software.
LEADING DESIGNERS HTC (above), Compal, Inventec	LEADING DESIGNERS Quanta, Compal (above), Wistron, Asustek, FIC	LEADING DESIGNERS Sanyo, Premier (above), Altek, Primax	LEADING DESIGNERS Compal, Cellon (above), Flextronics, BenQ	LEADING DESIGNER Gemtek (above), Dell CyberTAN, Huawei

Data: iSupply Corp.

A photograph of a farmer standing in a vast, golden field of crops, likely corn, under a clear sky. The farmer is wearing a light-colored shirt and dark pants, and is looking towards the camera. The field is filled with rows of crops, and the horizon is visible in the distance.

Colitic, Indiana, an hour shy of sun-up and a farmer is getting to work.

From Fayetteville to Fresno, if it's way before early,
farmers are getting to work.

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creating millions of jobs.

The American farmer is essential to the economy.
That's why we work to be essential to him — creating thousands of products
from farm crops, hundreds of markets for farm crops.

shops. Just ask the top brass at HTC, which creates and manufactures smart phones for such wireless service providers as Vodafone and Cingular as well as equipment makers it doesn't identify. "We know this kind of product category a lot better than our customers do," says HTC President Peter Chou. "We have the capability to integrate all the latest technologies. We do everything except the Microsoft operating system."

Or stop in to Quanta's headquarters in the Huaya Technology Park outside Taipei. Workers are finishing a dazzling structure the size of several football fields, with a series of wide steps leading past white columns supporting a towering Teflon-and-glass canopy. It will serve as Quanta's R&D headquarters, with



thousands of engineers working on next-generation displays, digital home networking appliances, and multimedia players. This year, Quanta is doubling its engineering staff, to 7,000, and its R&D spending, to \$200 million. Why? To improve its shrinking profit margins—and because foreign clients are demanding it. "What has changed is that more customers need us to design the whole product," says Chairman Barry Lam. For future products, in fact, "it's now difficult to get good ideas from our customers. We have to innovate ourselves."

Sweeping Overhaul

INDIA IS EMERGING AS A HEAVYWEIGHT in design, too. The top players in making the country world-class in software development, including HCL and Wipro, are expected to help India boost its contract R&D revenues from \$1 billion a year now to \$8 billion in three years. One of Wipro's many labs is in a modest office off dusty, congested Hosur Road in Bangalore. There, 1,000 young engineers partitioned into brightly lit pods jammed with circuit boards, chips, and steel housings hunch over 26 development projects. Among them is a hands-free telephone system that attaches to the visor of a European sports car. At another pod, designers tinker with a full dashboard embedded with a satellite navigation system. Inside other Wipro labs in Bangalore, engineers are designing prototypes for everything from high-definition TVs to satellite set-top boxes.

Perhaps the most ambitious new entrant in design is Flextronics. The manufacturing behemoth already builds networking gear, printers, game consoles, and other hardware for the likes of Nortel Networks, Xerox, HP, Motorola, and Casio Computer. But three years ago, it started losing big cell-phone and PDA orders to Taiwanese ODMs. Since then, CEO Michael E. Marks has shelled out more than \$800 million on acquisitions

to build a 7,000-engineer force of software, chip, telecom, and mechanical designers scattered from India and Singapore to France and Ukraine. Marks's splashiest move was to pay an estimated \$30 million for frog design Inc., the pioneering Menlo Park, Calif. firm that helped design such Information Systems icons as Apple Computer Inc.'s original Mac in 1984. Since then, Flextronics has developed its own basic platforms for cell phones, routers, digital cameras, and imaging devices. His is to make Flextronics a low-cost, soup-to-nuts developer of consumer-electronics and tech gear.

Marks has an especially radical take on where all the work is headed: He believes Western tech conglomerates are on the cusp of a sweeping overhaul of R&D that will rival the offshoring shift of manufacturing. In the 1990s, companies like Flextronics "completely restructured the world's electronics manufacturing," says Marks. "Now we will completely restructure design." When you get down to it, he argues, some 80 percent of engineers in product development do tasks that can easily be outsourced—like translating prototypes into workable designs, upgrading mature products, testing quality, writing user manuals, and qualifying parts vendors. What's more, most of the core technologies in today's digital gadgets are available to anyone. And circuit boards for everything from cameras to

work switches are becoming simpler because more functions are embedded on semiconductors. The

really hard technology work" is migrating to chipmakers such as Texas Instruments, Qualcomm, Philips, Intel, and Broadcom, Marks says. "All electronics are on the same trajectory of becoming silicon surrounded by plastic."

Why then, Marks asks, should Nokia, Motorola, Sony-Ericsson, Alcatel, Siemens, Samsung, and other brand-name companies all largely duplicate one another's efforts? Why should each spend \$200 million to develop a new smartphone when they can just buy the hardware designs? The ultimate result, he says: Some electronics giants will shrink their R&D forces from several thousand to a few hundred, concentrating on proprietary architecture, setting specifications, and managing global R&D teams. "There is no doubt the product companies are going to have fewer people doing design stuff," Marks predicts. "It's going to get ugly."

Granted, Marks's vision is more than a tad extreme. T



GOLDEN PEDIGREE
Apple uses iPod's American design as a selling point

More on Outsourcing, Only at BusinessWeek.com

"Designed by Apple in California": A look at Apple Computer's contrarian devotion to the art of product design.

Flextronics CEO Michael Marks gives his radical view on the future of outsourcing electronics design.

A Question of Design: Look at brand-name products designed and made by other companies in our interactive slide show.

Who Stays, Who Goes? How companies are deconstructing R&D to decide what can be done overseas—and what can't.

A Chat with Ideo's Tim Brown on outsourcing development.

The Empathy Economy: "Design thinking" gives U.S. companies an edge that can't be beat.

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despite the tech recovery, many corporate R&D budgets have been tightening. HP's R&D spending long hovered around 6% of sales, but it's down to 4.4% now. Cisco Systems' R&D budget has dropped from its old average of 17% to 14.5%. The numbers also are falling at Motorola, Lucent Technologies, and Ericsson. In November, Nokia Corp. said it aims to trim R&D spending from 12.8% of sales in 2004 to under 10% by the end of 2006.

Close to the Heart

STILL, MOST COMPANIES INSIST they will continue to do most of the critical design work—and have no plans to take a meat ax to R&D. A Motorola spokesman says it plans to keep R&D spending at around 10% for the long term. Lucent says its R&D staff should remain at about 9,000, after several years of deep cuts. And while many Western companies are downsizing at home, they are boosting hiring at their own labs in India, China, and Eastern Europe. "Companies realize if they want a sustainable competitive advantage, they will not get it from out-

CO-PILOT India's HCL will co-develop systems for Boeing's 7E7

sourcing," says President M. Armbrrecht of the India Research Institute, which corporate R&D spending.

Companies also worry the message they send investors. Outsourcing manufacturing, tech support, and back-office work makes no clear financial sense. But ownership of design is so close to the heart of a corporation's intrinsic value that a company depends on outsiders for design, investors might ask, how much intellectual property does the company own, and how much of the profit from a hit product flows back into its own coffers, rather than being paid out in licensing fees? That's one reason Apple Computer lets the world know it develops its hit products in-house, to the point of etching "Designed in California" on the back of each iPod.

Yet some outsourcing holdouts are changing their tune. Nokia long prided itself on developing almost everything itself—to the point of designing its own chips. No longer. Even the complexities of today's technologies and supply chains "nobody can master it all," says Chief Technology Officer Pertti Korhonen. "You have to figure out what is core and what is context." Lucent says outsourcing some development makes sense so that its engineers can concentrate on next-generation technologies. "This frees up talent to work on new product lines," says Dave Ayers, vice-president for platform and engineering. "Outsourcing isn't about moving jobs; it's about the flexibility to put resources in the right places at the right time."

It's also about brutal economics and the relentless demand of consumers. To get shelf space at a Best Buy or Circuit City often means brand-name companies need a full range of products, from a \$100 point-and-shoot digital camera with a few megapixels, say, to a \$700 8-megapixel model that doubles as a videocam and is equipped with a powerful zoom lens. On top of this, superheated competition can reduce hit product prices to cheap commodities within months. So they must get out

HIDDEN HANDS

Their names don't appear on the products. But a group of little-known companies are coming up with the designs for an increasing number of products sold under top brands, from Motorola and Palm to Hewlett-Packard and Dell. Some examples of the leading players:

COMPANY	DESCRIPTION	R&D STAFF	KEY PRODUCTS DESIGNED
CELLON U.S.	This independent design house, spun off from Philips' cell-phone business, has big labs in China and France.	800	Wireless handsets for Philips, Siemens, Haier, others.
COMPAL Taiwan	A top developer of computers that now is the leading producer of mobile phones.	1,000*	Notebooks, cell phones for Motorola, Toshiba, Sony-Ericsson, others.
FLEXTRONICS Singapore	Manufacturing services giant bought frog design last year to beef up its global design capabilities.	7,000	Cell phones, printers, telecom equipment for undisclosed customers.
HTC Taiwan	This contract manufacturer is a top designer of wireless digital handheld devices.	900	Smart phones for palmOne, T-Mobile, Audiovox, Verizon, others.
PREMIER Taiwan	Like many other contract suppliers, Premier does original design. Its specialty: digital cameras and projectors.	450	Cameras, imaging devices for HP, Fuji Photo Olympus, Konika, others.
QUANTA Taiwan	The world's top manufacturer of laptops, expanding into cell phones and networked digital home appliances.	7,000	Notebook PCs, consumer appliances for Dell, Apple, Sony, others.
WIPRO India	The world's largest contract R&D house for telecom, auto, and electronics.	8,000	Telecom equipment, auto electronic systems, chips for undisclosed customers.

*Includes PC and cell-phone divisions

Data: Companies, iSuppli Corp. BW estimates

How to go from prototype to finished product.



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door fast to earn a decent margin. "Consumer electronics have become almost like produce," says Michael E. Fawkes, senior vice-president of HP's Imaging Products Div. "They always have to be fresh."

Such pressures explain outsourcing's growing allure. Take cell phones, which are becoming akin to fashion items. Using a predesigned platform can shave 70% of development costs off a new model, estimates William S. Wong, a senior vice-president for marketing at Cellon. That can be a huge savings. As a rule of thumb, it takes around \$10 million and up to 150 engineers to develop a new cell phone from scratch. If Motorola or Nokia guess wrong about the market trends a year into the future, they can lose big. So they must develop several versions.

With most of its 800 engineers in China and France, Cellon creates several basic designs each year and spreads the costs among many buyers. It also has the technical expertise to morph that basic phone into a bewildering array of models. Want a 2-megapixel camera module instead of 1-megapixel? Want to include a music player, or change the style from a gray clamshell to a flaming-red candy-bar shape? No problem: Cellon engineers can whip up a prototype, run all the tests, and get it into mass production in a Chinese factory in months.

Moving Up the Food Chain

COMPANIES ARE STILL figuring out exactly what to outsource. PalmOne Inc.'s collaboration with Taiwan's HTC on its popular Treo 650 smart phone illustrates one approach. Palm has long hired contractors to assemble hardware from its own industrial designs. But in 2001, it decided to focus on software and shifted hardware production to Taiwanese ODMs. PalmOne designers still determine the look and feel of the product, pick key components like the display and core chips, and specify performance requirements. But HTC does much of the mechanical and electrical design. "Without a doubt, they've become a part of the innovation process," says Angel L. Mendez, senior global operations vice-president at palmOne.

QUANTA'S LAM "It's now difficult to get good ideas from our customers"

"It's less about outsourcing and about the collaborative way in design comes together." The PalmOne has cut months off of development times, reduced defects by

and boosted gross margins by around 20%.

Hewlett-Packard, a company with such a proud history of innovation that its advertising tag line is simply "invent. works with design partners on all the hardware it outsources." "Our strategy is now to work with global networks to leverage the best technologies on the planet," says Dick Conrad, senior vice-president for global operations. According to HP, HP is getting design help from Taiwan's Quanta and Hai Precision for PCs, Lite-On for printers, Inventec for servers and MP3 players, and Altek for digital cameras. HP won't identify specific suppliers, but it says the strategy has brought benefits. Conrad says it now takes 60% less time to get a new concept to market. Plus, the company can "redeploy our assets and resources to higher value-added products" such as advanced printer inks and sophisticated corporate software, he says.

How far can outsourced design go? When does it get to the point where ODMs start driving truly breakthrough concepts and core technologies? It's not here yet. Distance is one barrier. "To be a successful product company requires intimacy with the customer," says Azim H. Premji, chairman of India's Wipro. "That is very hard to offshore in fast-changing markets. Another hurdle is that R&D spending by ODMs remains relatively low. Even though Premier develops most of its own cameras and video projectors, "the really core technology," such as digital signal processors, is invented in the U.S., says vice-

BY DEPENDING ON OUTSIDERS FOR DESIGN, A COMPANY RISKS SENDING THE WRONG MESSAGE TO ITS INVESTORS

ident Hsieh. Premier's latest work is a size video projector, for example, based on a rough design by Texas Instruments, developer of the core technology. With margins shrinking fast in the ODM business, however, Premier and other Taiwanese companies say they need to move up the innovation food chain to reap higher profits.

That's where Flextronics and design acquisitions could get interesting. Inside frog's hip Sunnyvale

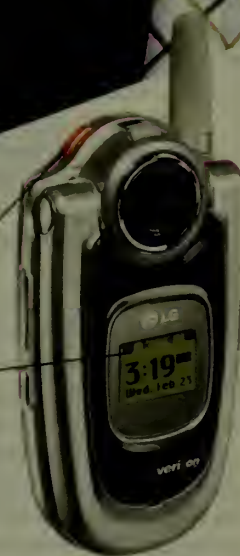
office, designers are working to create a radically new multi-touch device, for an unnamed corporate client, that won't hit the market until 2007. The plan, says Patricia Roller, frog's co-CEO, is to use Flextronics software engineers in Ukraine or India to develop innovative applications, and for Flextronics engineers to design the working prototype. Flextronics then would manufacture the gadgets, probably in China.

Who will ultimately profit most from the outsourcing of innovation isn't clear. The early evidence suggests that too many Western titans can remain leaders by orchestrating global innovation networks. Yet if they lose their technology edge or their touch with customers, they could be tomorrow's shrinking conglomerates. Contractors like Quanta and Flextronics that are moving up the innovation ladder, meanwhile, have a shot at joining the world's leading industrial players. What is clear is that an army of in-house engineers no longer means a company can control its fate. Instead, the winners will be those most adept at marshaling the creativity and skill of workers around the world. ■

—With Manjeet Kripalani in Bangalore, Andy Reinhardt in Cannes, Bruce Nussbaum in Somers, N.Y., and Peter Burrows in San Mateo, Calif.

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Phil Purcell's Credibility Crisis

Investors want Morgan Stanley's chief to beef up weak businesses—or dump them

FOR YEARS, MORGAN STANLEY Chief Executive Philip J. Purcell seemed invincible. The bank's return on equity and profits soared past most of its peers'. So did the stock price, which reached 109 on Sept. 11, 2000. Wall Street adored its one-stop-shop model, created when Dean Witter—with its retail brokerage network and Discover credit-card operation—bought Morgan Stanley and its storied investment bank in 1997. Everything was going Purcell's way.

No longer. Today, Purcell is under fire. Integrating the two firms has proven much tougher than many investors expected. That might be O.K. if the different segments were stellar stand-alone businesses. But while the investment bank remains a star, the former Dean Witter operations are laggards as Morgan plays catch-up with rivals who have bigger and more profitable retail brokerage and credit-card outfits. Almost eight years into the merger, the investment bank is still doing the heavy lifting, accounting for 62% of

operating earnings. The brokerage contributes just 6%.

Investors are not pleased. At 60 on Mar. 9, the company's stock price has been flat the past year, underperforming many of its rivals, though it has risen 18% since Nov. 30. The weak performance has revived tensions brought on by the merger in part because Morgan's senior bankers get about one third of their compensation in stock. Some investors worry that if the stock doesn't recover sharply, unhappy bankers could walk.

As Morgan's Mar. 15 annual meeting in Chicago nears, investors, analysts, and even some employees are calling on Purcell to fix the problem by selling the firm's mediocre businesses. At the very least, they believe he should shake up the management at some of the units. Scott Sipprelle, a former Morgan Stanley managing director who's now a hedge-fund manager, sent a letter to Purcell and the board arguing that the merger was a mistake. In a recent meeting with a senior executive, he took direct aim at what he says is the firm's ill-fitting mix of businesses,

poor regulatory record, and cozy board directors. Five of the 11 board members, including Purcell, once worked for consultant McKinsey & Co. "This is not a non-issue," says a Morgan spokesman. "Some director overlap is inevitable when shareholders demand the highest caliber directors for their board." Morgan also says it has put a lot of effort in proving its regulatory record. Purcell declined to be interviewed.

The attacks are part of an open salvo on Purcell. On Internet message boards, investors poke fun at Purcell about everything from his niece's job as Discover general counsel and his son's mortgage deal last year to the bank's recommendation against a shareholder proposal to cap CEO pay. Morgan says his niece was a crucial member of Discover's antitrust fight against Visa and MasterCard, and the terms of the son's mortgage were available to anyone qualified. Institutional Shareholder Services is also recommending investors vote against the pay-cap proposal because it is arbitrary. Some insiders complain that the New York-based company shelled \$467,142 last year for Purcell's personal travel by corporate jet. The board says the expense is justified because Purcell must use the jet for security reasons.

WAL-MART CARD DEAL

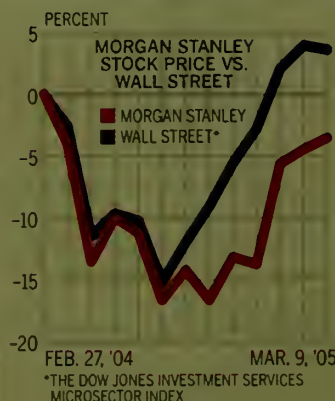
PURCELL HAS ACKNOWLEDGED publicly since last November that Morgan Stanley's returns have sunk to "the middle of the pack." Although 2004 net income jumped 18%, to \$4.5 billion, the firm lagged far behind Goldman Sachs Group's 52% profit leap and Lehman Brothers Inc.'s 39% rise. But Purcell refuses to take the drastic actions demanded by critics. In meetings with investors and employees, he insists the best course is not to draw up a radical plan, but merely to execute better—raising his critics' ire even more.

Whether he eventually succeeds or not, Purcell seems likely to remain standing for now. He's backed by a board that recently gave him a 47% raise even as the company's shares were falling, though he is still paid less than the top Street chief. And some investors, who believe Purcell will keep the firm's retail brokerage and credit-card operations, want to own the stock anyway as merge

Why the CEO Is Under Fire

- Morgan Stanley's **stock price** has trailed behind the shares of most of its peers over the past year
- The bank used to boast the industry's best **return on equity**, but now it's below average at 16.8%
- Morgan's **profits** rose 18% last year, but earnings at rivals Goldman Sachs and Lehman Brothers grew at least twice as fast
- The old Dean Witter's **retail brokerage** operations haven't pulled their weight since it bought Morgan Stanley in 1997, contributing only 6% of the bank's operating earnings last year

Data: UBS, Bloomberg Finance Markets





OPEN SEASON Criticism is mounting, but a loyal board could keep Purcell in power

General Electric Co. and processed by the Discover network. The cards will have all three brand names on them. "But there's growth and then there's growth," cautions David Robertson, publisher of *The Nilson Report*, a credit-card industry newsletter. "If Discover issues a credit card [instead of just putting its name on one], that's far more profitable."

In January, Purcell conceded to investors that he will "re-assess" selling Discover if it doesn't start to deliver sufficient growth. However, he said he wouldn't make a decision for at least two years, and he didn't reveal specific growth targets. Guy Moszkowski, financial-services analyst at Merrill Lynch & Co., says Morgan has "articulated a growth strategy, and because they're pursuing it, I don't see them spinning off the business anytime soon."

COMPLETE CONTROL

PURCELL'S CHALLENGE with retail brokerage is equally tricky. Rivals such as Merrill Lynch have a roster of wealthier clients, analysts say. Merrill also has raced ahead of Morgan in segmenting customers and offering them tailored advice. It

shows in the numbers:

The operating profit margin of Morgan's retail brokerage business was 10% in 2004, excluding litigation costs, vs. 19% at Merrill, estimates Fox-Pitt Kelton. After wringing out costs over the past year, Purcell argues that the brokerage is now in a better position to com-

pete. He doesn't see selling it as an option because it's crucial to his strategy of building a diversified bank based on the fastest-growing services.

The criticism Purcell is facing is especially stinging because he has been in complete control of the firm. Since former President John J. Mack left in 2001, every division now reports directly to Purcell. What's more, the underperforming units were part of Dean Witter,

y picks up. "The real selling point of stock today is the top-notch investment bank," says Bob Maneri, a managing-director at Victory Capital Management in Cleveland, which bought 100,000 shares for one fund last fall after Morgan announced disappointing earnings and the stock dropped.

till, Morgan Stanley is in a strategic Selling the businesses that don't fit would appear obvious, but it's not that. Sure, Morgan Stanley might quicken its pace about \$10 billion if it sold Discover. Its image as a blue-collar card has been difficult to shake, and it doesn't have the global heft to compete with the big boys for marketing deals and customers. Some investors believe a logical buyer would be Citigroup, Bank of America, or JPMorgan Chase & Co. But though it's not growing, Discover still turns out cash, supplying 19% of

earnings. Analysts say it has a higher return on equity than many other divisions. "They can't sell it, because they can't easily replace the earnings hole," says UBS financial-services analyst Glenn Schorr.

Purcell has told investors that a U.S. Supreme Court antitrust ruling last fall forbidding Visa and MasterCard from restricting banks from issuing other cards will give Discover a new lease on life. One strategy is to focus on the fastest-growing part of the market, debit cards. In November, the firm bought debit-transaction processor PULSE EFT Assn., which will allow Discover to issue debit cards to its 40 million card holders. It also struck a deal to issue Wal-Mart Stores Inc.-branded cards, financed by

**One fear:
Bankers may
walk if the
stock doesn't
pick up**

where Purcell served as CEO when he engineered the \$10 billion takeover of Morgan. The firm's lackluster share price has even sparked speculation that Purcell might some day be forced to sell Morgan Stanley to JPMorgan, Bank of America, or HSBC, though most bankers dismiss such talk.

In effect, one of Wall Street's master salesmen now faces one of his toughest selling jobs. Few chiefs have been better at talking people into seeing things their way—and gained as much power from it—as Purcell. Whether he was persuading one of the Street's most

**Fidelity
sold 13%
of its
Morgan
stock late
last year**

venerable investment banks to agree to a takeover in 1997 or courting top executives to stay after Mack's departure, Purcell has usually prevailed.

Purcell repeatedly tries to demonstrate to investors that the mediocre results trouble him and that he's on top of the

problem. He has emphasized to groups of investors in two investor conferences over the past five months that once again producing premium returns is his top priority. He recently flew to Boston to meet with the company's third-largest shareholder, Fidelity Investments, whose funds sold 13% of their Morgan stock in the last quarter of 2004. While critics focus on recent results, Morgan prefers to highlight the long term. Morgan's chief administrative officer, Stephen S. Crawford says the firm's average return on equity over the past eight years was 22%, which is one-fifth higher than its peers.

Morgan Stanley needs to get its mojo back or it risks becoming nothing special. And for now, the firm's fate is in Purcell's hands. During a Jan. 27 investors' meeting, he told people that although he was unhappy with the firm's returns, he was pleased with progress made in every one of Morgan Stanley's businesses. One person asked Purcell if the firm did so well last year, what hurt its returns? Purcell suggested that if he could have just changed "a few things," the firm would have come out ahead, though he did not go into specifics. Now it's time for him to deliver. ■

—By Emily Thornton in New York,
with Stanley Reed in London and Aaron
Pressman in Boston



Dirty Rotten Little Scoundrels

The SEC has a new plan to turn up the heat on small-time Wall Street fraudsters

TO SECURITIES & EXCHANGE Commission gumshoes, it was a classic case of pump and dump. Last June, financier Donald E. Oehmke and Bryan Kos, a stock promoter, merged a small private labor-recruitment company into a shell corporation that Oehmke controlled. With the new company, Concorde America Inc., trading on the Pink Sheets quotation-and-trading service for unlisted stocks, the duo allegedly cranked up a stock-promotion scheme replete with phony analyst reports, press releases, and spam e-mails. Concorde's stock price soared from \$3 to \$8.90. But on Aug. 11, Concorde's management issued a press release disavowing any involvement in two earlier rosy releases—and its share price plunged to

\$2.51 the next day. By then, according to the SEC, Oehmke and Kos had dumped shares, pocketing \$11.3 million and \$1.3 million respectively.

They may not get to keep their winnings. In February, the SEC persuaded a federal judge in Florida to freeze their assets and filed civil fraud charges against them and six other defendants. Oehmke denied the charges in court on March 11. Kos's lawyer also denied the charges. Concorde and its lawyer declined comment on the SEC complaint.

Enron it's not. But SEC enforcers know that despite their three-year drive to miscreants among Wall Street's big small-time swindlers continue to flourish. So SEC Enforcement Director Stephen Cutler is zeroing in on micro-cap firms with a novel strategy and new tactics. In the past, SEC lawyers chased swindlers

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CUTLER Zeroing in on brokers, promoters, and lawyers

one company at a time. Now the agency is targeting gatekeepers such as broker-dealers, promoters, and lawyers, who show up in scam after scam. And rather than waiting months until it can prove intent to defraud, the SEC is halting trading in companies that it suspects are about to be monkeyed with as soon as it finds what it considers clear-cut evidence of violations.

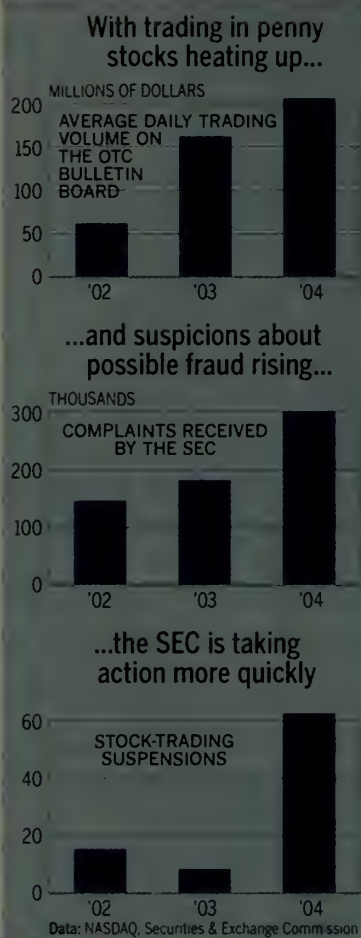
The campaign to squelch micro-cap fraud is part of SEC Chairman William H. Donaldson's push to get ahead of abuses before they cause investors widespread harm. Last year, Cutler spotted telltale signs of a possible resurgence in scams, including a jump in new issues on the Pink Sheets and soaring volume on the OTC Bulletin Board. "The message of the Enron and WorldCom prosecutions seems to be resonating with big companies, their boards, and management," says Cutler, who has made the crack-down one of his top five priorities this year. "What I worry about is whether that message is equally resonant among folks in the micro-cap world."

Making sure it is will be a tough challenge. Stock-fraud cases require legwork and resources to unravel convoluted transactions. Unlike big-company executives, micro-cap fraud suspects tend to say "see you in court" rather than "how fast can we settle?" when they get a subpoena. And while criminal prosecutors have been eager to pursue mega-frauds, most shy away from time-consuming micro-cap cases.

To meet the threat, Cutler quickly pulled together a team of 10 investigators,



CRACKING DOWN ON STOCK SCAMS



Internet sleuths, and market-surveillance experts. After scouring SEC databases for patterns of manipulation, they devised a plan of attack focused on:

REPEAT PLAYERS By going after gatekeepers, the SEC can shutter operations that could rip off many more investors. The SEC's complaint against Oehmke and Kos, for example, alleges that they were also inflating the stock price of shell company Absolute Health & Fitness Inc., reaping total net profits of \$14.4 million. Oehmke denied the charge in federal court on Mar. 4. Kos's lawyer also denied the charges.

The securities cops are training their sights in particular on recidivists. On Feb. 25, the SEC filed charges against California attorney Kevin J. Quinn for drafting securities filings on behalf of three penny-stock offerings despite being disbarred in California in 1997, suspended from practicing before the agency in 1999, and barred by the SEC in 2000 from participating in any penny-stock sale. Quinn's lawyer did not return calls.

THE AL CAPONE TACK

Just as G-men ultimately nailed the notorious mobster on tax-evasion charges, the SEC is policing easily provable violations such as failing to register stock issues properly. Once it spots ongoing or potential fraud, the agency often halts trading. In the past, suspensions averaged 10 a year; last year the SEC stepped in 63 times.

On Mar. 3, the SEC moved against CMKM Diamonds Inc., a Canadian diamond exploration company incorporated in Nevada. The SEC cited the company for failing to file financial statements for two years. Another red flag was massive

trading, averaging 1.1 billion shares in February on the Pink Sheets for a whose price remained a fraction of a penny. Knowledgeable sources say regulators suspect the company or affiliated shareholders were flooding the market with stock. Neither CMKM Diamonds nor its lawyer returned calls. In a Mar. 4 release, CMKM Co-Chairman Robert Maheu said: "We have been aggressively gathering the essential information needed to comply with our public disclosure obligations and anticipate working with the SEC to ensure our compliance with all federal regulations."

TIGHTER RULES The commission is expected to vote soon on a proposal to require public shell companies from using streamlined stock-registration procedures designed to cut costs for small businesses. The measure also would require pre-trade disclosure of business and financial information on any company acquired by a public company. "This would effectively close the window during which promoters can take advantage of investors' lack of access to information about the business," says Steven Moskowitz, of New York law firm H. Berg & Krause LLP. But, he adds, the change would jack up legal and accounting costs for companies that legitimately use shells to go public.

HELP FROM OTHER REGULATORS In many cases, con artists work both sides of the border, the SEC and Canadian authorities are working harder to share information. The SEC's move against CMKM was a result of a cease-and-desist order against the company issued by Saskatchewan securities officials last fall for allegedly trading unregistered shares. Calls to the company's lawyer were not returned. Also under discussion are ways the SEC and NASD could build speed bumps for micro-cap sector. Under discussion: requiring broker-dealers to put up more capital and to tell investors more about the risks when selling them penny stocks.

Many market experts laud the SEC's cleanup campaign. The only thing missing, they say, is more criminal prosecutions. "The prospect of jail time is only real deterrent," says former SEC enforcement attorney Jacob S. Frenkel, a partner with Shulman Rogers Gandy Pordy & Ecker. The SEC says it's doing the best to get federal and state prosecutors involved. But until then, count on the SEC's securities cops to use all the weapons in their arsenal to keep the market sure on.

—By Amy Borrus in Washington



RICH TARGET
An audience
advertisers love

Mighty Week

The pithy news digest is a must-read for America's movers and shakers

AS A SECOND ACT, IT seemed risky even for the eccentric British publisher Felix Dennis. By launching a news digest in 2001 called *The Week*, aimed at the intelligentsia, Dennis was jumping into the highly competitive fray of weekly magazines. Getting frat to gobble up his earlier U.S. titles, laddie titles *Maxim* and *Stuff*, one thing. But who in the top power would have a regular appetite for led news and columns?

any, it turns out. *The Week* has quiet- become a must-read for politicians, urities, and CEOs who like its smart alation and snappy presentation, as as its array of subjects, from skepti- about election results in Tajikistan to alvador Dali exhibit at the Philadel- Museum of Art to the "steal of the k," in one case a \$260,000, four-bed- 1, 112-year-old Victorian in Red Oak, . Stories are lifted and compressed a variety of sources by a team of 20 rs, led by newspaper veteran am Falk. An editorial staff number- ewer than two dozen is certainly one ost saving vs. other weeklies, since e's no original reporting. Snippets in ent issue came from the National Re- Online, Germany's *Die Zeit*, *Enter-*

tainment Weekly, Bloomberg.com, and Tehran's *Jam-e-Jam*. Dennis has boasted that if you read *The Week* cover to cover, you'll be the smartest-sounding person at your Friday night cocktail party.

DISPROVING THE SKEPTICS

IT'S A CONCEPT Dennis has nurtured for a decade, ever since he bought a majority position in the British edition of *The Week*. The magazine was originally started by Sir Jolyon Connell, a onetime White House beat reporter who came up with the idea after watching West Wing staff assemble the daily briefing of events for the President. Upon return to Britain, Connell launched *The Week* with virtually no advertising. Dennis took notice and made an undisclosed offer. Today, Britain's *The Week* has a circulation of about 100,000, virtually all subscriptions, more than *The Economist's* subscriptions there.

Now the U.S. version is disproving the early skeptics. It raised

its circulation rate base by 50%, aiming for 300,000 for this year, nearly all subscriptions. Its ad pages grew by 25%, and ad revenues rose by 66%, to \$11 million, in 2004, beating other newsweekly and industry averages, even if the totals were much smaller. With \$20 million in total revenues last year, it has yet to make money but is on target to break even next year, says General Manager Justin Smith. What's working so well? "We have a time-pressed audience who wants more perspective and a greater range of opinions," says Smith, 35, a former corporate strategist for Economist Group Ltd. "We are sort of a blog in print, but with a higher-end readership." (The average household income of its readers is \$137,000.)

The irony is that the magazine's success may be due as much to the advertising it turns away as to the ads it runs. That's because *The Week* limits ad pages to just 30% of the book, vs. an average 48% ad ratio for all magazines, to avoid a cluttered feel. "We joke that we are a magazine that has already been TiVoed," says Smith. "We have taken out most of the interruptions." In the post-ad-bust era, it's a policy bordering on heresy in magazine circles, but Smith insists that 66% annual gain in ad dollars shows that the formula is working.

Advertisers say they like the idea of being able to reach a small, wealthy audience. Altria Group Inc., formerly Philip Morris Cos., bought more ad pages last year in *The Week* than in any other publication, says David Sylvia, Altria's director of external communications. "As we undertook our rebranding," he says, "it was important to reach that influential audience." Janet Cerutti, vice-president for media at Swatch Group (U.S.) Inc., says

Buzz of The Week

Few gave this digest a chance to survive, but it has gained an elite following. A few tricks:

READERS Celebrities and power brokers get free subscriptions. Then *The Week* gives them some free publicity, printing their praise on the cover. Fans include Barry Diller, Yahoo! CEO Terry Semel, and Luciano Pavarotti.

SOURCES *The Week* doesn't have a staff to do original reporting, instead paying for stories from news services and lifting them directly from publications by saying it's fair use. Publications don't mind since it's all attributed and now even call to try to get their stories placed.

EVENTS By forging relationships with such highbrow groups as the Conference Board and Aspen Institute, *The Week* sponsors regular events, from CEO breakfast forums to an annual award for opinion and commentary writing.

she places ads for the company's luxury brands, such as Blancpain and Longines, in *The Week*. "We like that they restrict ads," she says. "It gives us much greater attention."

Most magazines offer complimentary subscriptions, but *The Week* goes a step further by aiming at big names. The hope is that once hooked, they will agree to publicly praise the magazine, which features testimonials on its cover.

LUNCH AT MICHAEL'S

SELF-SERVING? Sure—and a nice pay-back for a cadre of new loyal readers who can never get enough free publicity for themselves. Among *The Week's* flock: Woody Allen, who once said the magazine was "for movers and shakers, and I can't stop shaking." Mario M. Cuomo is a fan. So are Yahoo! Inc. CEO Terry S. Semel, UBS Chairman Don Marron, and former Representative Barry M. Goldwater Jr. More than 55%

Limiting ads is one reason for *The Week's* success

of those targeted will choose to cough up the full \$75 yearly rate after about 18 months, when various discounted offers expire, says Smith.

In addition to the gimmicky endorsements, *The Week* is attempting to create a salon of

sorts for opinion makers. It has forged a relationship with the Conference Board, holding breakfast forums with CEOs on subjects ranging from "the art of the turnaround" to "recommendations to the President from the private sector." It also hosts lunches among New York's power set at Michael Jordan's restaurant in Grand Central Terminal. And on Mar. 8, *The Week* held its first-ever Opinion Forum for columnists and opinion writers at the Freer Gallery of Art in Washington. The leadership nonprofit Aspen Institute is a partner. *The Week* then handed out awards for the best commentary, editorial, and opinion writing.

In a category that is hardly new, *The Week* may be the most innovative effort since *Reader's Digest* launched 83 years ago with just 5,000 copies. For Felix Dennis, the challenge will be weighing the allure of grabbing new ad dollars against maintaining the intelligent brevity that has made *The Week* required reading. ■

—By Tom Lowry in New York

On the Hot Seat At Biogen

How CEO Jim Mullen managed a drug crisis after alarming news broke

JAMES C. MULLEN, THE 46-year-old chief executive of Biogen Idec Inc., has a degree in chemical engineering—and the demeanor to match. He's an unruffled, just-the-facts-ma'am kind of guy. So when he first learned that Tysabri, his company's breakthrough drug for multiple sclerosis (MS), might be responsible for a deadly brain infection, he moved quickly but calmly to find out what happened and to make sure it didn't happen again. And he did all this while sticking to a long-scheduled commitment to his four children: a family vacation in Florida.

Mullen received the first reports about the two sick patients on Feb. 18, in the com-

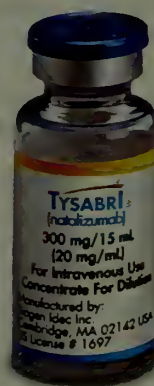
pany's small conference room in Cambridge, Mass. He had no reason to expect such dire news. Just one day earlier, Biogen and Elan Corp., the co-developer of Tysabri, had released results from a two-year clinical trial showing that the

drug was safe and highly effective. Tysabri had received an expedited approval by the Food & Drug Administration last November, and analysts were predicting that the drug would generate \$1 billion in annual sales in short order.

RARE BRAIN DISEASE

THE TURN IN FORTUNES was extreme and rapid. Dr. Burt A. Adelman, Biogen executive vice-president for research and development, told Mullen within an hour of learning the news that at least one and possibly two patients in the ongoing clinical trial of Tysabri had developed an extremely rare brain disease called progressive multifocal leukoencephalopathy (PML). "The fact that this bounced immediately to my office showed how serious the situation was," Mullen says. He quickly issued orders: Alert the FDA at once, disclose all known facts, and inform every doctor involved in the trial. A methodical investigation in place and responsibilities delegated, Mullen took a flight to Florida.

None of Biogen's executives was surprised that



TYSABRI Two MS patients contracted a fatal illness

ENGINEER AT THE HELM

James C. Mullen

"Here was a risk we didn't understand.... Stopping the drug was the right thing"

BORN In 1959, outside Syracuse, N.Y.

EDUCATION B.S., chemical engineering, Rensselaer Polytechnic Institute, 1980; MBA, Villanova University, 1984.

POSITION President and CEO, Biogen Idec

BIG DEAL

In 2003 he merged Biogen with Idec Pharmaceuticals in a \$7 billion stock swap that created the world's top biotech company.

BIGGEST CHALLENGE

llen left the premises, giving his dedication to his family. But colleagues also noted it wasn't much of a vacation, since he was constantly reachable by phone. "He was very calm, as always," says Craig E. Schneier, executive vice-president for human resources. "He instituted the appropriate procedures. We never felt any sense of panic." Still, Schneier acknowledges that "I instantly felt uneasy once the boss was back," on Feb. 25. By then, the first patient diagnosed with PML had died; three years later, Biogen, in consultation with the FDA, decided to suspend sales of Tysabri. The drug's removal left investors, employees, and patients in shock. PML is extremely rare and, although Biogen had been monitoring its patients for infections, Mullen says they never anticipated this disease. The disappointment within Biogen was enormous. "I've seen people weeping in the halls," says Schneier. Even so, once the diagnosis was confirmed, Mullen felt there was only one responsible action. "Here was a risk we didn't understand, and patients had other options. Stopping the drug was the right thing to do."

Some investors, however, criticized the company for pulling the drug too precipitously, and Biogen's shares plunged 6%, to \$38.65, the day the drug was withdrawn. A few days later a shareholder lawsuit was filed, charging that Biogen had withheld information about the risks associated with Tysabri. Mullen says he never considered the legal ramifications—"the first time I got aggravated was when I was talking to too many



SANGFROID Mullen put a methodical probe in place and delegated responsibility

had any profits to report. "Those setbacks were more threatening to the core of the business," says Mullen.

He didn't initially choose to work in such a risky industry. After graduating from Rensselaer Polytechnic Institute in 1980, he took a job at the former SmithKline. "I figured it would be a challenge," he says. Nine years on, he decided it wasn't so challenging and joined Biogen, then a tiny startup. Mullen distinguished himself by taking on an assignment far afield of engineering: In 1996 he moved to Paris to build Biogen's European sales operation. "I didn't know what I was doing," he says. "That was a blast."

Mullen returned to Cambridge to take over as CEO in 2000, and three years later merged Biogen with Idec Pharmaceuticals Inc., turning two struggling companies into the world's No. 3 biotech. Besides Tysabri, Biogen sells four other

drugs, including Avonex, the best-selling MS treatment. Mullen returned to Cambridge to take over as CEO in 2000, and three years later merged Biogen with Idec Pharmaceuticals Inc., turning two struggling companies into the world's No. 3 biotech. Besides Tysabri, Biogen sells four other

drugs, including Avonex, the best-selling MS treatment.

Tysabri was meant to take Biogen to a new level of profitability. The drug marks a novel approach to treating MS by preventing rogue immune system cells from entering the brain and attacking the myelin sheaths that protect nerve fibers. In clinical trials, Tysabri proved twice as effective as older interferon-based drugs, and had far fewer side effects.

Those results prompted some 5,000 patients to take Tysabri in the four months it was available, and the company is getting 1,000 calls a day from MS sufferers eager to continue their treatment. But no one knows when, if, or in what form Tysabri will be available again. Biogen is meeting with medical experts and reviewing the records of all 3,000 patients in its clinical trials, a process that could take months. Analysts predict that the drug could return by 2006, but with very strong warnings that may scare off patients. Mullen refuses to make any such predictions. Like the engineer he is, he's waiting for the facts. ■

—By Catherine Arnst in Cambridge, Mass.

MARKET OVERREACTION?

AMID THESE CONCERNS, Mullen is also preparing for an expected Securities & Exchange Commission investigation into several large stock sales by Biogen executives shortly before the company learned of the sick patients.

Despite all this, Mullen thinks investors have overreacted. "People paint this setback like the company is going out of business. But in 2004 we were profitable without Tysabri," earning \$45 million on revenues of \$2.2 billion. In his 16 years at Biogen, costly development programs for drugs to treat AIDS, rheumatoid arthritis, and hepatitis B have all flopped, and that was before the company

had to pull its new sclerosis drug after only a few months on the market.

DES Moved to Paris to oversee Biogen's first international drug operations in the late 1990s, though he had no drug background and no fluency in European languages.

Returned to Cambridge in 1999 and a year later was named president and CEO, one of the few engineers to head a biotech outfit.

FAMILY Married to Justine; four children, ages 6 through 12.

HOBBIES "Well, I have four children. That about does it."

**“WE CAN TURN ON A DIME.
IF IT’S A REALLY,
REALLY BIG DIME.”**



There it is. Over there. That great opportunity. You try to get everyone in your place to go after it. That's when you realize what three years of belt-tightening have done. The "lean times" business model doesn't quite match the new "time to grow again" agenda. How do you get more responsive? More flexible? **"THROUGH YOGA?"**

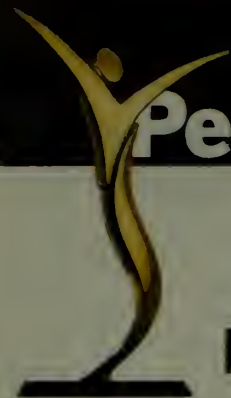
We're talking about the kind of flexible that makes you an on demand business. The kind that IBM Business Consulting Services can help you with. We have years of experience in virtually every industry, helping companies align business goals with on-the-ground practices. So we're in a unique position to offer insights into business model issues. Is your problem a clogged business process? Is it your corporate culture? Is it workflow related? We'll help you zero in on what's working and what's creating drag. **"SOUNDS PRETTY MAJOR."**

Not as major as you might think. Why? Once we've identified what your problem areas are, we prioritize change. So you can tackle one bite-sized issue at a time, one ROI at a time. We don't just come up with a plan and hand you off to someone else, either. What we strategize, we can deploy.

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The S&P/
BusinessWeek
Annual
Awards

The Best Fund Managers

Here are the 2005 winners of the Standard & Poor's/
BusinessWeek Excellence in Fund Management Awards. **BY ADRIENNE CARTER**

A GOOD MUTUAL-FUND MANAGER is tough to find. Between the industrywide scandals and the schizophrenic market, it's getting harder for investors to pick the real stars. That's why we've made it easier by teaming up with our sister company, S&P, to confer the 2005 annual Standard & Poor's/*BusinessWeek* Excellence in Fund Management Awards. ¶ The awardees are an eclectic mix of managers and management teams that cover the investing universe—everything from large-cap value to foreign stocks to municipals bonds. Those who run each of the 18 winning funds have weathered a variety of market conditions and have shown they have the right stuff. Half of them, including the well-known Bill Miller of Legg Mason Value Trust, have been honored before. The others include many people you may not have heard of, such as Lawrence Babin of Victory Diversified

Stock Fund, a large-cap fund, and a bond whiz Thomas Fetter of Eaton Vance Municipal Bond Fund.

Our winners from the past two years have maintained a strong batting average. The 2004 top equity-fund manager earned 13.3% on average, compared to 12.3% for the S&P 500-stock index (from Mar. 11, 2004, when the best awards were announced, to Mar. 4, 2005). Our two top bond-fund managers beat the Lehman Brothers Aggregate Bond Index, 2.8% vs. 1.4%, over the same time period. The winners of 2003 did even better, with our honorees averaging 43%, vs. the market's 37% in the year after they were named.

To select the winners, we put each fund through a rigorous vetting. We start with *BusinessWeek's* annual Mutual Fund Scoreboard (BW—Jan. 24 and Jan. 31), searching for funds with an A or B+

First-Time Winners

FUND / SYMBOL	CATEGORY	PORTFOLIO MANAGER
ABN AMRO Mid Cap CHTTX	Mid-cap Blend	Thyra Zerhusen
Dodge & Cox Income DODIX	Interm. Bond	Team managed
Eaton Vance Municipal Bond ETMBX	Muni Nat'l. Long	Thomas Fetter
Goldman Sachs Growth Opps. GGOAX	Mid-cap Growth	Steven Barry & team
Goldman Sachs Mid Cap Value GCMAX	Mid-cap Value	Eileen Rominger & team
Laudus Rosenberg Intl. Small Cap. RISIX	Foreign	Team managed
T. Rowe Price Growth Stock PRGFX	Large-cap Growth	Robert Smith
T. Rowe Price Equity Income PRFDX	Large-cap Value	Brian Rogers
Victory Diversified Stock SRVEX	Large-cap Blend	Lawrence Babin

Repeat Performers

FUND / SYMBOL
Calvert Social Investment Equity C
Growth Fund of America AGTHX
Harbor Bond HABDX
Julius Baer International Equity BJ
Legg Mason Value Trust LMVTX
Managers Bond MGFIX
TCW Galileo Total Return Bond TGL
Thornburg Value TVAFX
Tweedy, Browne Global Value TBGV

in their respective categories. Those marks identify which ones have performed the best over the past five years on a risk-adjusted basis.

TESTED AND SCREENED

THERE WERE OTHER considerations. We wanted managers with at least 10 years at the helm, so we could be sure they were the people really responsible for the ratings. We also ruled out funds with less than \$100 million in assets. It's because it's easiest for managers of small funds to stand out and much harder when the funds are bulked up. The funds have to be readily accessible to our readers, so we eliminated those with a minimum investment greater than \$26,000. Also gone were funds now closed to new investors. That narrowed the list to 40 finalists. Then the S&P analysts dug deeper, examining the year-by-year returns. "We think it's a better test of stock-picking ability to provide a trail of consistent performance rather than one year followed by several mediocre years," says Philip Edwards, managing director of S&P's Investment Services. Expenses, turnover, and management were factored into the decision.

The team also sat down with the managers—asking, for instance, "How do you handle risk?" and "Do you have strategies with the market conditions?" "We're looking for managers with a clear philosophy," says Edwards. "If you don't know where the goal line is, you're never going to make it." No worries about that here. Our best managers have shown they know how to win.

BusinessWeek online For more information on interviews with the best managers, go to businessweek.com/extras

	PORTFOLIO MANAGER
Blend	Daniel Boone III
Growth	Team managed
Mid	Bill Gross
	Rudolph-Riad Younes
Blend	Bill Miller
Bond	Dan Fuss
Int'l.	Jeffrey Gundlach and team
Blend	William Fries
	Team managed



SAVVY Zerhusen likes companies with 'economic moats'

Taking a Page From the Sage

Like Warren Buffett, Thyra Zerhusen invests in just a handful of companies that she has studied in depth

THYRA ZERHUSEN IS clear about her role model: "I want to be the female Warren Buffett," she says. The portfolio manager of ABN Amro Mid Cap Fund says with a laugh. Then, embarrassed by her unexpected bravado, she adds: "Oh, I don't know. I try to emulate him, at least." Indeed, like Buffett, Zerhusen practices a know-what-you-own philosophy, investing in just a handful of companies she has studied in depth. She also believes in long-term investing, seeking companies with sustainable business models. She looks for businesses with "economic moats," franchises and patents that

can resist the onslaughts of their rivals.

If her goals sound lofty, she has always aimed high. As an undergrad, she studied life sciences at the Swiss Federal Institute of Technology, alma mater of Albert Einstein. "He failed the entrance exam on his first try," Zerhusen notes. "I didn't." She received a master's in economics from the University of Illinois and has worked in the investment industry

ABN AMRO MID CAP FUND

CATEGORY
Mid-cap Blend

PORTFOLIO MANAGER
Thyra Zerhusen

AVERAGE ANNUAL TOTAL RETURN*
15.3%

*Appreciation plus reinvestment of dividends and capital gains before taxes, 2000-2004

in Chicago for the past 25 years. Her fund has consistently beaten its peers since she took the helm in June, 1999. In the five years ended on Dec. 31, she delivered an annual return of 15.3%, double the return of the average mid-cap blend fund.

During much of her tenure, Zerhusen has held 20%-plus of the fund's assets in the beleaguered tech sector. "My tech portfolio is pretty mundane," she says. "The only thing I demand is that the company's products not be facing obsolescence problems or severe competi-

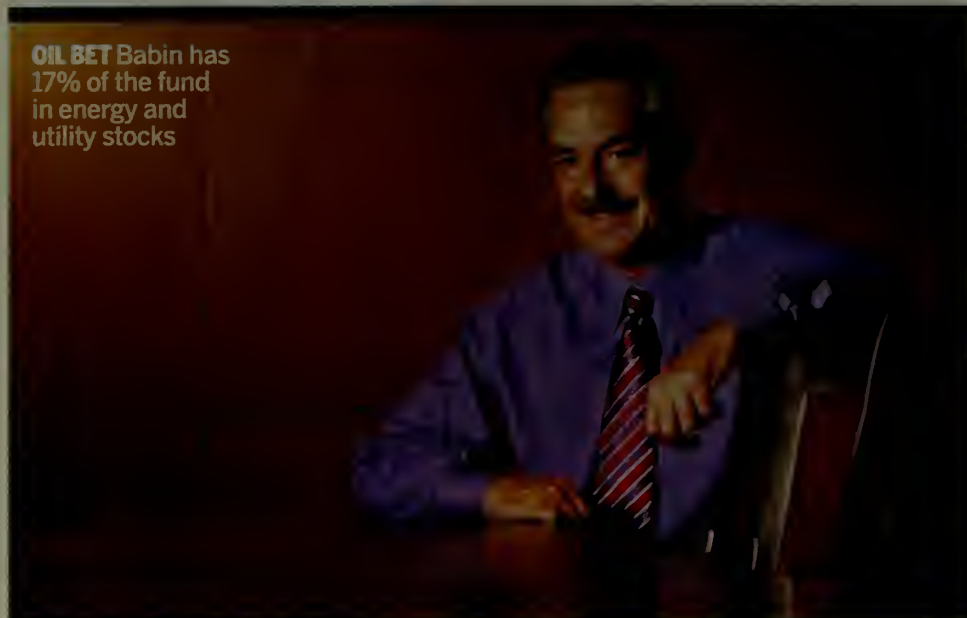
tion"—and that the company is profitable. She likes Diebold, a maker of automated-teller and voting machines. She also favors Unisys, an info-tech-services company that has several long-term contracts with the government, so sales are locked in. "Unisys has a backlog of \$6.5 billion in service contract orders," she says.

Zerhusen typically holds fewer than 50 stocks. She wants her companies to be focused as well. "It's important with mid-size companies that they stick with what they know best. They often don't have the

depth of management to handle new businesses," she says.

Although mid-size stocks in the billion-to-\$10 billion market cap range rallied in recent years, Zerhusen says they still offer better investment opportunities than blue chips. "Mid-caps offer higher growth rates and lower valuations than larger companies, yet they continue to be ignored by many investors, especially large pension plans," she says. If Zerhusen proves right, she'll be a step closer to emulating Buffett. —Lewis B.

OIL BET Babin has 17% of the fund in energy and utility stocks



A Fund Thrives In Cleveland

Victory Diversified consistently turns in above-average results despite being far from the Street

CLEVELAND ISN'T EXACTLY a financial mecca. Few fund managers call it home, and major chief executives rarely pass through. But that's just fine by Lawrence Babin, portfolio manager of the \$2.5 billion Victory Diversified Stock Fund since 1989. "We don't get the same information flow as the New York financial community that plays together and eats meals to-

gether," says Babin, who grew up in the city's suburbs. "But we don't get caught up in the hype, either."

The result has been steadily above-average performance. The large-cap blend offering has produced annualized gains of 13.7% since 1995. In fact, on Babin's watch, the fund has had just a single losing year—2003—when it lost 23%, in line with the Standard & Poor's 500-stock index. That's why in the five-year period ended Dec. 31, the fund was up just 3.4%

annually. Still, Babin's competitive turns in and year out put him in the middle of the pack; similar funds lost an average of 1.6% a year over the same time period.

The key is flexibility. Babin and his team look for sectors they think will benefit most from current economic conditions and business trends. That top-down approach helps him figure out which groups to emphasize. Although he maintains some exposure to each sector of the S&P 500,

Babin will make bets. Sector weightings may be as much as twice as much of the benchmark as little as half. At the same time, Babin drills down into the companies, looking for stocks with relatively cheap valuations. But he's wedded to a value approach. At

Babin has paid up for businesses with especially strong growth prospects. The fund usually owns 50 to 60 stocks, making it more concentrated than your typical equity fund with 130 companies.

Right now, Babin has around 17% of the fund in the energy and utility sectors, up from 12% for the S&P 500. He believes continued strong global demand and limited supply should keep oil prices at elevated levels. As he sees it, oil isn't going to fall below \$40 a barrel anytime soon and could even soar as high as \$80 within the next decade. That's why he counts Transocean and Unocal among his largest holdings. Wall Street, he says, has just started to recognize value in these companies, and as prices are moving up. Getting into stocks early makes all the difference between an average manager and one who stands out. —Adrienne C.

VICTORY DIVERSIFIED STOCK FUND

CATEGORY
Large-cap Blend

PORTFOLIO MANAGER
Lawrence Babin

AVERAGE ANNUAL TOTAL RETURN*
3.4%

*Appreciation plus reinvestment of dividends and capital gains before taxes 2000-2004

Sticking to their Convictions

Dodge & Cox managers produce top-notch returns often by ignoring what the market is favoring

PORTFOLIO MANAGERS AT many mutual fund companies use a revolving door. The typical manager spends no more than five years running any particular portfolio, and many jump ship couple of years. But at the \$8.1 billion Dodge & Cox Income Fund, the person management team has an

average tenure of 12 years on the fund, and many in the group have been with the firm for at least 15 years. "People tend to come to Dodge & Cox and spend their entire career," says team Dana Emery, a team member at the San Francisco firm since 1983.

That long-term commitment is echoed in the fund's philosophy. The group has consistently produced top-notch returns

by sticking with its convictions no matter what the market is favoring. The members' in-depth analysis gives them the confidence. After Xerox' bankruptcy scare four years ago, for example, Dodge took a big stake in Xerox' debt securities, originally paying 55¢ on the dollar. "We spent a lot of time looking at the value of [Xerox] assets, talking with management, and determining if it could weather the liquidity crisis," says Emery. "Given our research, we were comfortable with the investment." Today, some of the bonds have matured, and some remain in the portfolio. Both have shown a profit.

Such canny plays have been the key to Dodge's superior performance over the years—annualized gains of 8.2% since 2000. That's 1.2 percentage points a year better than the competition. It also helps that fees are modest. The expense ratio is just 0.45% vs. 1.07% for similar funds.

Now the managers have turned conservative in the face of rising interest rates. They're keeping the duration—a measure of the fund's sensitivity to interest-rate changes—below that of the Lehman Brothers Aggregate Bond index. As corporate bond yields have nudged up close to U.S. Treasury yields, the team has also lightened up on some of its corporate debt and increased its government bonds. Corporate bonds now make up 32% of the portfolio, down from 40% a few years ago.

With the fund's returns in the middle of the pack for the past year, some critics may take issue with the cautious stance. But the nine managers with a collective 162 years of experience in the business have learned they do best when they stick with their convictions. —Adrienne Carter

DODGE & COX INCOME FUND

CATEGORY
Intermediate
Bond

PORTFOLIO
MANAGER
Team managed

AVERAGE ANNUAL
TOTAL RETURNS*
8.2%

*Appreciation plus reinvestment of dividends and capital gains before taxes, 2000-04



TAKING THE LONG VIEW Charles Pohl, Thomas Dugan, Dana Emery, Peter Lambert, and Bob Thompson are part of a nine-person team

A Deep Pool of Fund Talent

Steven Barry's edge comes from having a savvy team of 23 portfolio managers



BARRY Looks for "strong franchises"

AT MANY FUNDS, JUNIOR staffers work as analysts—scouring financial statements, interviewing executives, and building revenue models—before moving up to portfolio manager. Not so at the \$1.5 billion Goldman Sachs Growth Opportunities Fund. "Everyone on the team is an analyst, too," says Steven Barry, senior portfolio manager.

Barry counts 23 co-portfolio managers and analysts, while funds at smaller shops have only two or three. That deep well of talent is the primary reason for the fund's success. Its 8.1% five-year annualized return well surpasses the -3.7% average for mid-cap growth funds.

Although they run a mid-cap

fund, team members also keep tabs on large-cap and small-cap stocks in different industries. That way Barry, whose specialty is technology and consumer stocks, will understand the impact of, say, Microsoft launching a new software module on the companies in this fund.

GOLDMAN SACHS GROWTH OPPORTUNITIES FUND

CATEGORY
Mid-cap Growth

PORTFOLIO MANAGER
Steven Barry & team

AVERAGE ANNUAL TOTAL RETURN*
8.1%

*Appreciation plus reinvestment of dividends and capital gains before taxes, 2000-04

Barry can also account for competitors that wouldn't show up on a list of mid-cap stocks. "If you're investing in retailers, you want to stay out of the way of Wal-Mart," he says. For instance, Barry is a big fan of PETCO Animal Supplies, which sells a lot more than just 40-lb. bags of kibble. "Wal-Mart has been succeeding in the pet category," he says. "But PETCO serves a more high-end customer base." A growing number of these customers are empty

nesters who spoil their pets and gourmet treats and chew toys PETCO.

Barry's team also looks for companies with a "strong franchise," a dominant market share and a recognizable product. Although Barry clearly has that trait, it's not always obvious in mid-caps, which often make other businesses rather than consumer products. "A midsize company may have a strong franchise and brand name, neither you nor I are going to compete with it," he says.

Besides the fund, Barry's team manages \$30 billion in growth-stock and private accounts. But with so many analysts involved, there's no shortage of investment ideas. "With 23 people, we have an advantage in this market," he says. In that regard, Barry heads a successful franchise, too. —Lewis B.

Poetic License

Fund manager—and bard—Robert Smith says to be successful, you have to take risks

The cabin saved me from the storm/But also when the rainbow came/The shades were drawn, the covers taut/I felt those opposites the same./Because I felt nothing at all/And

never saw how close the wreck/And never cheered the winds first still/As I might have up on deck. So begins Robert Smith's poem *Up on Deck*—a metaphor, says the manager of T. Rowe Price Growth Stock, for taking risks in the stock market. "Writing is very therapeutic," he says. "If

I'm having three or four bad days in a market, the pain just leaves when I write a poem."

Luckily for Smith's investors, there hasn't been too much pain—relative to other large-cap growth funds, at least. The fund's five-year annualized return is barely positive, just 0.3% a year, but the category average is -6.6%.

Smith believes the fortunes for the sector are about to change, and he doesn't want to be hiding in his cabin when it happens. "A lot of really smart people work hard in this business and do well because they're afraid of taking risks," he says. "They don't want to invest in troubled companies because they're afraid of looking foolish. And they don't want to own companies that have

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T. ROWE PRICE GROWTH STOCK FUND

CATEGORY
Large-cap
Growth

**PORTFOLIO
MANAGER**
Robert Smith

**AVERAGE ANNUAL
TOTAL RETURN***
0.2%

*Appreciation plus reinvestment
of dividends and capital gains
before taxes, 2000-04

formed well because they're afraid of them falling." In short, they end with average stocks and so-so results.

In the present-day market, Smith believes, many blue chips are relatively cheap. So why settle for average companies?

"Marquee corporations such as Wal-Mart Stores, General Electric, and Microsoft have had good earnings growth in recent years, yet their stocks have done nothing," he says. As a result of this inertia, Smith says this is a "great buying opportunity."

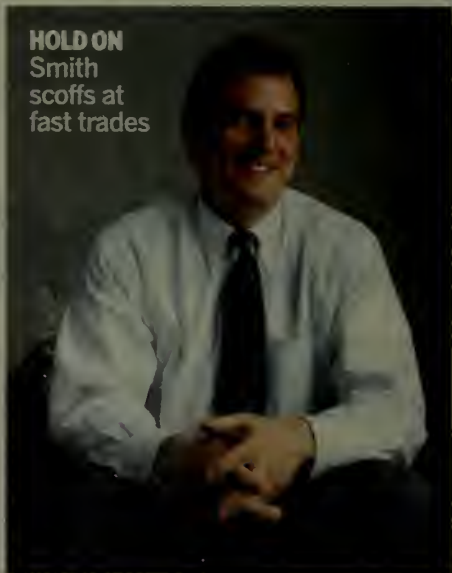
KNOW WHEN TO HANG ON

WHEN SMITH BUYS, he holds. The fund's turnover ratio is a low 35%, less than half his peers' 89% average. That means he typically owns a stock for three years. Smith scoffs at the rapid trading found at many growth-stock funds because he believes that "if you own a great company, you don't need to sell it." That said, he will sell or reduce the size of a holding if it becomes too expensive. When a company's forecasted price-earning ratio is more than double the stock's expected earnings growth rate, he pares back. So if the growth rate is 20%, he considers the stock expensive at a p-e of 40.

That's not much of an issue now. Given all the blue-chip bargains, he's expecting more rainbows than stormy weather ahead.

—Lewis Braham

HOLD ON
Smith
scoffs at
fast trades



NOT A SOLO ACT
Team members
Sean Gallagher,
Andrew Braun,
and Rominger

A Sharp Eye For Value

At Goldman Sachs, Eileen Rominger scouts out companies where things are starting to look up

FOR EILEEN Rominger, being a value investor is not just about picking cheap stocks. The manager of the Goldman Sachs Mid-Cap Value Fund wants to buy shares of companies that are changing for the better. That requires a lot of hands-on research. "We conducted 1,200 meetings with company managers over the past year," she says.

Needless to say, Rominger is not a solo act. As CIO of Goldman's U.S. Value

GOLDMAN SACHS MID-CAP VALUE FUND

CATEGORY
Mid-cap Value

**PORTFOLIO
MANAGER**
Eileen Rominger
and her team

**AVERAGE ANNUAL
TOTAL RETURNS***
17.5%

*Appreciation plus reinvestment
of dividends and capital gains
before taxes, 2000-04

Team, she oversees 14 portfolio managers and analysts who are constantly scouting the market for investment opportunities. The results are impressive. The fund's five-year annualized return easily beats the 12.1% average for mid-cap value funds.

How she values a company changes depending on the industry. So rather than simply looking for every company with a low price-earnings ratio, she uses different valuation measures for different industries. For instance, in the medical industry she uses free cash flow, but in

gy sector she looks at oil or gas reserves. Why? Cash flow can be quite high in an energy company, even though it has low reserves. "If the company runs out of its reserves, that cash flow is unsustainable," Rominger says. That's not the case in the media business, where cash flows tend to be more predictable.

Rominger's favorite is EOG Resources, a natural gas company with enough reserves to last its customer base 13 years, and a price-to-book ratio lower than its peers. Here, Rominger sees several catalysts for im-

provement. "The rate at which North American producers are running out of reserves is accelerating," she says. That bodes well for natural gas prices. And EOG is more efficient at finding and producing natural gas than its peers. Finally because gas reserves are falling, several mergers are in the works. EOG could be a target.

MOTHER OF FOUR

ROMINGER KEEPS A well-diversified portfolio—currently 83 stocks—and tries not to let her industry weightings stray

too far from her benchmark, the Russell Midcap Value Index. That diversity helps keep volatility down and has led to better risk-adjusted returns.

Rominger is not only a busy fund manager, overseeing \$2.5 billion in the fund and \$14 billion at Goldman overall. She's the mother of four children, including twins in the seventh grade. Small wonder she has little time for hobbies. "Reading stock reports makes for an entertaining activity for me," she says. Lucky for her fund's shareholders. —Lewis Braham

Contrarian To the Core

After 20 years, T. Rowe Price's Brian Rogers gets a high from depressed stocks

HERE WERE FEW STOCK market enthusiasts in the summer of 1981. Long-term Treasury rates hovered around 14%, the economy was falling into recession, and equities had downright dismal. But Brian Rogers, then an intern at a management consulting firm in Boston, was captivated. "There was a contrarian appeal," recalls Rogers, who, after graduating from Harvard Business School in the spring of 1982, shunned the then-glamorous world of consulting in favor of money-management at firm T. Rowe Price.

More than two decades later, that spirit still serves him well at the \$18.9 billion T. Rowe Price Equity Income Fund, the firm's largest offering. He has managed a portfolio which, since it opened in 1982, has racked up impressive gains by buying up stocks other investors have shunned. From its inception, the fund has posted annualized returns of 13.4%, outpacing other large-cap value funds by 1.5 percentage points a year. "Invariably, we're looking at companies where investors are concerned about the prospects," says Rogers, who also serves as T. Rowe's chief investment officer. "That concern creates opportunity."

Indeed, Rogers favors stocks with high dividend yields and historically low price-earnings ratios—characteristics typical of companies under a cloud of bad news. For example, he scooped up shares of Coca-Cola in late 2004, after worries about its leadership and financial prospects drove the shares down from 54 to around 40. At that point, the stock was

GOOD MEDICINE
Media and drug stocks appeal to Rogers now



trading hands for just 18 times earnings and yielding 2.5%, well above the Standard & Poor's 500-stock index. Those cheap valuations, combined with the company's strong cash flow and topflight brand, gave Rogers the confidence to jump in as others were bailing out.

Today, Coke trades at 44. But he thinks that, like most of his purchases, it's an investment worth holding on to for at least three years. Of course, he'll sell a stock sooner if its valuations appreciate more quickly or hold it longer if he believes there's room to grow. The fund's annual turnover runs between 15% and

30%—meaning his typical holding period is between three years and six years. "There are some stocks we've held for 20 years and some we've undoubtedly sold in a couple of months," says Rogers.

His emphasis on dividends also makes this fund a smart choice for income-

oriented investors. Rogers aims to keep the fund's payout 25% higher than that of the S&P 500 in the long term. Currently the fund yields about 1.9%, compared with 1.6% for the index.

Like most other contrarian investors, Rogers has a few surprises in his portfolio. Media and pharmaceuticals—the traditional stomping ground of growth investors—look especially appealing right now, he says. As such, he likes Time Warner, Viacom, Wyeth, and Abbott Laboratories. "Growth stocks are cheap by historical standards," says Rogers. "I have no idea if it will work out in 2005 or 2006, but I feel like it's a good bet." The records show Rogers' bets often pay off. —Adrienne Carter

T. ROWE PRICE EQUITY INCOME FUND

CATEGORY
Large-cap Value

PORTFOLIO
MANAGER
Brian Rogers

AVERAGE ANNUAL
TOTAL RETURNS*
7.7%

*Appreciation plus reinvestment of dividends and capital gains before taxes, 2000-04

At the **Top** of The Muni Game

How Thomas Fetter got Eaton Vance Municipal Bond Fund in winning form

THOMAS FETTER, AN AVID golfer, knows the importance of having your head in the game. At a club tournament near Providence, R.I., last year, the 17-handicapper finished round one in the top spot. But he lost his focus the next day, shooting a 97 and ceding the lead. So he read *Golf Is Not a Game of Perfect* by Bob Rotella to brush up on golf's mental aspects. "The mechanics are important, but golf's also a mind game," he says.

So is investing. And few muni bond managers play as well as Fetter, who runs the

EATON VANCE MUNICIPAL BOND FUND

CATEGORY
Municipal
National Long
PORTFOLIO MANAGER
Thomas Fetter
AVERAGE ANNUAL TOTAL RETURNS*
8.2%

*Appreciation plus reinvestment of dividends and capital gains before taxes, 2000-2004

\$250 million Eaton Vance Municipal Bond Fund. The Ohio native started as a muni bond salesman four decades ago and joined Eaton Vance in 1986 to run the fund. His fund has posted five-year average annual returns of 8.2%, outpacing peers by nearly 1.5 percentage points a year.

Fetter typically hunts for out-of-favor debt securities. For example, he picked up \$15 million worth of California bonds a couple of years ago after the state's budget crisis adversely affected the prices, driving up the yields on the investment grade debt. Now that the bonds have recovered, he has pared back his stake.



VALUE HUNT
Fetter seeks out-of-favor issues

While the bulk of his portfolio is investment grade, he also devotes a portion to lower-quality and unrated bonds. Right now, the fund has 25 such securities, pushing up its yield to 5.6%, vs. 3.8% for other long-term funds. Fetter and his team of nine analysts keep the risk in check, researching each issue thoroughly.

The fund's relatively small size lets it be nimble. While \$50 million to \$100 million issues may be largely overlooked by megabillion-dollar funds, Fetter can easily buy big stakes in smaller bonds. "We have access to more opportunities," he says. Such an advantage helps keep Fetter's mind in the game. —Adrienne C.

Model Workers

At Laudus Rosenberg, computer programs do the picking for the fund's 900-stock portfolio

TALKING WITH TECH support is far more important than interviewing company managers at Laudus Rosenberg International Small Capitalization Fund. That's because computer programs call the shots, picking the 900 or so stocks in the portfolio. Its five-year annualized return is 12.7%, vs. -0.3% for all foreign funds.

The fund is run by a 35-person team of analysts, traders, and programmers at the Orinda (Calif.) money-management firm. Computer models analyze some 6,000 to 7,000 companies on both valuation and earnings growth potential. The fund tends to buy companies with a market value of \$20 million to \$2 billion that are trading at a 10% to 15% discount to what the models estimate they are worth and whose earnings growth is

likely to outpace that of their peers over the next year. "Our tools allow us to do a more thorough job of analyzing those companies," says Stephen Dean, who heads the analyst team.

Then there's gut check. Team members have the power to freeze trading in any stock when they think recent market news is not reflected in the models. For example, a merger announcement or reports of accounting anomalies may cause the group to reassess the position. Call it tech's gut support. —Adrienne C.

LAUDUS ROSENBERG INTERNATIONAL SMALL CAPITALIZATION FUND

CATEGORY
Foreign
PORTFOLIO MANAGER
Team managed
AVERAGE ANNUAL TOTAL RETURN
12.7%

*Appreciation plus reinvestment of dividends and capital gains before taxes, 2000-2004

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THE EQUITY INVESTOR'S 26-WEEK MICRO-CAP REVIEW

SELECTED PROFILES OF THE NATION'S TOP PRICE-PERFORMING MICRO-CAP COMPANIES AS OF 12/31/04

From the approximate 2,400 domestic companies with market capitalizations under 200 million dollars, the following pages highlight selected top-ranking firms, in terms of share price performance for the 26-week period ending 12/31/04. Each profile describes a leading company including its industry, market trends and reasons for success, as written by company management. While past performance is never a guarantee of future results, these top-performing companies represent investment opportunities worthy of a micro-cap investor's close consideration.

Gain/Loss for the
26-Week Period
Ending 12/31/2004



Vital Images, Inc. • VTAL • Medical Imaging Software

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Key Manager Statement

"As physicians increasingly recognize the clinical benefits of enterprise-wide advanced visualization, they are turning to Vital Images for a broad range of applications from cardiac visualization and stroke analysis to lung cancer visualization and virtual colonoscopy. We have the leading technology and strong momentum in the marketplace."

Jay D. Miller, President & CEO

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Key Manager Statement

"Our company has been successful in building a well-balanced portfolio of high-quality assets, which is reflected in our extremely low ratio of non-performing assets to total assets. This is and will continue to be the focus of our quest toward building a high-performing financial services organization."

John S. Fiore, President and CEO

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Key Manager Statement

"Mpower's unique position in the telecom industry comes from our deep and dense facilities-based network, strong financial position, robust voice and data product portfolio, and industry leading customer and employee retention results."

Rolla P. Huff,
Chairman and CEO

GeoResources, Inc. • GEOI • Oil & Gas

Williston, ND • IR Contact: Cathy Kruse • 701-572-2020
www.geoi.net



GeoResources, Inc. is a natural resources company engaged in its principal business segments — oil and gas exploration and production and gas drilling; and the mining and manufacturing of leonardite-based products. GeoResources has a substantial oil and gas exploration and production operation in the Williston Basin. GeoResources has a subsidiary company, Western Star Drilling Company, for its own drilling use and available for contract drilling operations for others. GeoResources also operates a mine and processing plant where a distinctive type of oxidized lignite coal called Leonardite is mined from leased reserves and processed into several different specialty products.

THE EQUITY INVESTOR'S 26-WEEK MICRO-CAP REVIEW

MSGI Security Solutions, Inc. • MSGI • Technology

New York, NY • IR Contact: Jeremy Barbera • 917-339-7150

www.msgisecurity.com

MSGI Security Solutions is an international

technology solutions provider focused on homeland security, public safety and law enforcement. MSGI designs and develops video surveillance technologies, intelligence-gathering devices, and other edge IT-based safety and security. The company currently serves such as the U.S. Department of Homeland Security and other prominent government and private sector organizations. The company is headquartered in New York, with regional offices in Washington, DC; Calgary, Alberta; and Europe.

Key Manager Statement

"MSGI is rapidly expanding our integrated array of strategic solutions focused on decreasing the threat of terrorism and increasing homeland security in the United States and abroad. With multiple new video surveillance and law-enforcement products being introduced in international markets, MSGI is extraordinarily well-positioned to attain our revenue growth and profitability objectives."

Jeremy Barbera,
Chairman & CEO

LaBarge, Inc. • LB • Electronics Manufacturing

St. Louis, MO • IR Contact: Colleen Clements • 314-997-0800, ext. 409

www.labarge.com



LaBarge, Inc. is a recognized leader in the electronics manufacturing service industry. The company builds high-reliability electronic equipment and connects systems for customers in diverse end markets, including defense, aerospace, industrial, and government systems. LaBarge-built electronics support critical functions including durability and peak performance, including military aircraft and weapons systems, mine management systems, oil field down-hole instruments, glass container fabrication systems, satellite launch vehicles and airbag inspection systems.

Key Manager Statement

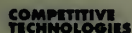
"LaBarge is achieving excellent growth by successfully executing its focused business strategy, including strategic acquisitions, expanding its blue-chip customer base and enhancing its broad-based capabilities."

Craig LaBarge, CEO & President

Competitive Technologies, Inc. • CTT • Technology Transfer

Fairfield, CT • IR Contact: Johnnie D. Johnson • 212-754-6565

www.competitivetech.net • jdjohnson@strategic-ir.com



Competitive Technologies, established in 1968, is a full service technology transfer and licensing provider focused on transforming technology needs of its customers into commercially viable solutions. CTT is a leader in identifying, developing, and commercializing innovative technologies in electronic, nano, and physical sciences developed by universities, companies and inventors. Customers pay license/royalty fees which are shared by CTT and its clients. Well positioned in the \$150 billion technology licensing market, CTT's portfolio includes: forensic evidence assay; MPEG-4 video compression; RFID tracking; sexual dysfunction therapy; sunless tanning; nanotechnology bone cement; SIC wafer testing; encryption technology; and Therapik® medical device.

Key Manager Statement

"We expect to achieve double-digit growth in revenue and net income for fiscal 2005. Our plan leverages near-term opportunities while executing longer-term profitable growth strategies to expand our recurring revenue stream and create shareholder value."

John B. Nano, President & CEO

The Exploration Company • TXCO • Oil & Gas

San Antonio, TX • IR Contact: Roberto R. Thomae • 210-496-5300 x214

www.txco.com • txco@txco.com



The Exploration Company is an independent exploration and production enterprise producing oil and natural gas in one of the hottest basins in North America, the Maverick Basin of Southwest Texas. The company uses advanced geological and geophysical technologies to explore and produce from its 554,000-acre lease block. As the Maverick Basin's largest leaseholder, TXCO is competitively positioned to explore and develop hundreds of multi-play/multi-pay drilling locations. At year-end 2004, TXCO had over 1,500 defined locations in its prospect inventory.

Key Manager Statement

"With a growing production rate and a well-defined, \$29+ million CAPEX program for 2005, I expect TXCO to further increase reserves and sales as we continue to demonstrate strong financial performance. With over 60 wells planned for 2005, we are still at an early stage of development in the Maverick Basin, considering our vast acreage position and prospect inventory."

James E. Sigmon,
President & CEO

Image Entertainment • DISK • DVD Media

Chatsworth, CA • IR Contact: Charles Messman • 818-556-3700

www.image-entertainment.com



Image Entertainment is America's leading independent licensee, producer and distributor of home entertainment programming. Image acquires exclusive distribution rights from content owners seeking an alternative to the major studios. The company's vast catalogue encompasses many genres including live music, stand-up comedy, urban, Latin, and television shows. Recent co-production agreements with ContentFilm and Dark Horse Entertainment will add new feature films to Image's growing library. Internationally, sub-licenses with Sony BMG, Warner Music and others provide the company with worldwide penetration throughout the home video, broadcast distribution markets.

Key Manager Statement

"We recently marked our fourth consecutive quarter of strong revenues and profits. Image's strategy of focusing on our core expertise—the acquisition of major independent programming and its exclusive distribution—continues to fuel our growth. Image's newly formed digital acquisition and distribution vehicle, Egami Media, provides significant growth potential."

Martin W. Greenwald,
President & CEO

Company Directory

Competitive Technologies, Inc.	212.754.6565
The Exploration Company	210.496.5300 x214
GeoResources, Inc.	701.572.2020
Image Entertainment	818.556.3700
LaBarge, Inc.	314.997.0800 x409
Mpower Communications	585.218.6550
MSGI Security Solutions, Inc.	917.339.7150
Synergy Financial Group, Inc.	908.956.3292
Vital Images, Inc.	952.487.9500

EDITED BY TODDI GUTNER



BANKING

E-Perks A-Poppin'

WANT TO KNOW IMMEDIATELY if someone just purchased a \$5,000 flat-panel TV with your credit card? This is one of the new, high-tech features banks are adding to their menu of customer services. Using software developed by **Adepra** of Norwalk, Conn., banks now can send automated alerts to customers by e-mail, fax, PDA, or phone. You can ask to be notified when a large credit-card purchase is made, specific checks clear, or a bank balance is running low. **Bank One** lets its checking and credit-card customers choose from free e-mail or phone alerts; its sister bank, **JPMorgan Chase**, also sends reminders to PDAs and pagers. At **Provident National Bank**, you can get an e-mail message when you reach the credit limit on your charge card.

Coming this summer: A new service from "aggregation" technology developer **Yodlee** of Redwood City, Calif. that will allow fund transfers among a variety of linked bank and nonbank accounts. It would be available to such banks as **Wachovia**, **Citibank**, and **Bank of America**, which allow clients to look at checking, loan, investment, credit-card, and 529 college-savings accounts all at once.

—Susan Garland

TIME OFF

DANCE-HALL PERFORMERS, absinthe drinkers, crowded markets—the nightlife and street life of Paris' Montmartre district was the central theme of **Henri de Toulouse-Lautrec's**



work at the end of the 19th century. The **National Gallery of Art in Washington** will highlight that teeming area in "Toulouse-Lautrec and Montmartre," Mar. 20 to June 12. More than 250 pieces—including *The Englishman at the Moulin Rouge*, left, and works of Picasso, Van Gogh, and other contemporaries—will be on display. The exhibit will open at the Art Institute of Chicago on July 16.

—Mike McNamee

TRAVEL

LET THAT PET RACK UP MILES

THE SKIES HAVE become more Fido Fluffy-friendly. **United Airlines'** frequent fliers can now earn 1,200 bonus miles when they fly with their pets. To qualify for United Pet Class, which ends on May 27, a pet must travel with a Mileage Plus member for at least one segment of a roundtrip flight. You can carry a small dog, cat, or bird onboard for \$80 one way on a domestic flight if the kennel fits under the seat. The other option is to have the pet travel as checked luggage in a heated cargo compartment for \$100 to \$200, depending on the animal's size. **El Al** offers pet points for its frequent fliers as well. Meanwhile, animal members of **Midwest Airlines'** Premier Pet Program can qualify for one free roundtrip for every three paid roundtrips they take with their owners.

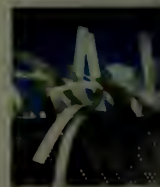
—Susan Garland



SECURITY

GET THEE TO A SHREDDER

CROSS CUT OR STRIP CUT? Come June 1, when a new federal identity-theft law takes effect, small employers may be pondering that question as they shop for a shredder. The law requires anyone who employs even one person to destroy credit-check and other employee records before tossing them. Cross-cut models, which make it harder to reassemble documents, are the best bet.

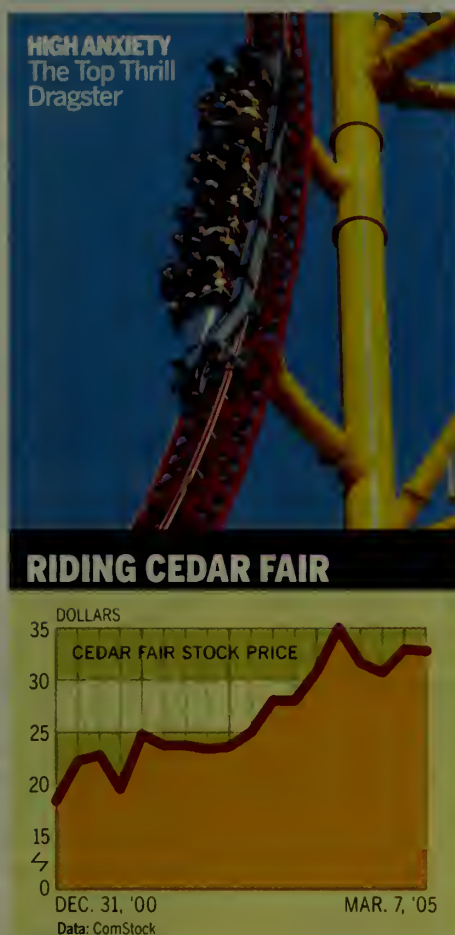


BY ROBERT BARKER

Cedar Fair: The Thrill Is Gone

I'll never catch me on Cedar Point's Top Thrill Dragster. One look at a photo of the world's tallest, fastest roller coaster throws me into acrophobic panic. At the same, I've been keeping an eye on the Ohio amusement park's parent, Cedar Fair. Its dividend yield inspires in me a vaguely cozy feeling. What's before the nagging doubts. Can Cedar Fair, which runs seven large amusement parks, plus five water parks, really offer such a rich yield? Or is it like the midway illusion? The answers are important to anyone seeking income from their portfolio, in part since they don't pay taxes just to Cedar Fair. Like 47 other companies, most of them trading on the New York Stock Exchange, Cedar Fair is a partnership but a master limited partnership. Because of that, its \$1.84 annual payout is considered a return of capital and so is not directly taxable, not at today's low rates (15% or 5%) on corporate dividends.

6% YIELD THAT'S TAX-FREE? You're right, that is way too good to be true. As a partnership, Cedar Fair each March sends its investors (or, in partnership terms, "unit holders") a Schedule K-1. This Internal Revenue Service form details each unit holder's share of Cedar Fair's income, depreciation, and other expenses. Income allocated to each unit holder is taxable at ordinary income-tax rates. For a high-income investor, that could easily be 35% or more, after state levies. So a decision to invest in Cedar Fair or other publicly traded partnerships is considerably more complicated. The first question, though, is not taxes but the health of the business. Attendance was up a bit, thanks to a park it bought last year. Without that acquisition, though, attendance would have declined 2.5%. When the company reports 2004 earnings in mid-March, Wall Street expects 6% growth in revenue, to \$540 million, but a 10% or so decline in earnings,



to perhaps \$1.50 a share, as the acquisition drove depreciation and other noncash charges higher. You can see this modest slump reflected in the price of Cedar Fair units (chart). In any case, Cedar Fair's cash flows remain healthy. In the 12 months ended September, cash flow from operations neared \$158 million, which proved more than enough to fund a 46% rise in capital spending plus 3.8% more in distributions, now running 46¢ a share each quarter.

So, how much of Cedar Fair's distributions do investors get to keep after taxes? The answer depends not just on your tax bracket but also on how long you hold the investment. Because of the way tax rules call for depreciation expenses to be allocated to partners, after the first year of owning Cedar Fair you would have to pay income tax on only a small slice of your distributions, perhaps 18%. But from there, it gets worse. After eight or nine years, when unit holders' share of partnership income is little sheltered by depreciation expenses, 90% or more of the distribution amount would be taxable. Averaged over the years, an amount equivalent to 50% to 60% of a long-term holder's distributions winds up being liable for current taxation, Cedar Fair Treasurer Brian Witherow told me. Uncle

Sam recovers the rest once the shares are sold. This makes Cedar Fair and the other partnerships especially suitable for investors who expect one day to be in lower income-tax brackets or those who want to pass the investment on to heirs, for whom the tax liability gets erased.

Because Cedar Fair's revenues, cash flows, and distributions have grown nicely since 1987, when it adopted the partnership structure, investors in that time saw average annual pretax returns of more than 14%. Much of that came as Cedar Fair bought parks, such as California's Knott's Berry Farm, from other operators. In the future, if fewer acquisition targets present themselves, Cedar Fair may have a harder time generating such returns. Like most every shiny carnival prize, Cedar Fair's yield turns out on close inspection to be duller than first glimpsed. ■

E-mail: rb@businessweek.com



BY GENE G. MARCIAL

A FRESH MARKETING PUSH COULD REVIVE PIER 1 IMPORTS.

NEW FINANCIAL MUSCLE AT TIME WARNER MAY POWER GROWTH.

HEALTHTRONICS' MEDICAL EQUIPMENT IS IN RED-HOT DEMAND.

All Gussied Up at Pier 1

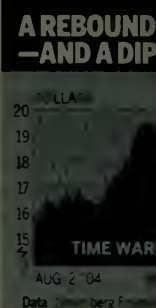
THE PAST TWO YEARS have been rough for Pier 1 Imports (PIR), No. 1 in imported decorative items: Its same-store sales and earnings took a dive. With the stock at 18.56, down from nearly 25 a year ago, most analysts remain wary. Indeed, Standard & Poor's rates Pier 1 a sell. But Rodney Hathaway of investment firm Heartland Advisors, who says he's a contrarian, spies a turnaround. Pier 1 has shipped out old wares and hauled in new—including a fresh ad blitz to fire up sales. “We expect a rebound in the next quarter,” he says. Its 1,000 stores “now look uncluttered and more attractive,” says Hathaway. The new push, he adds, includes higher prices on some items. Hathaway has a 12-month stock target of 30. He estimates earnings of 74¢ a share on sales of \$1.9 billion in the year ended February 2005, and \$1.12 in 2006 on \$2.7 billion. The retailer made \$1.31 in 2004 on sales \$1.8 billion. Pier 1 “remains our best idea for 2005,” notes Budd Bugatch of Raymond James & Associates in a Mar. 7 report. He rates the stock a strong buy.



Coming in Clearer At Time Warner

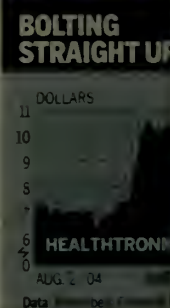
IS THE OLD Time Warner (TWX) back? Some pros think so—although the stock has yet to show it. Shares climbed from 15 in August to nearly 20 in December, then slipped to 17.53 on Mar. 9. “But great things are happening that spell growth,” says Benjamin Segal of Winchester Capital Group, which has bought shares. After settling a legal tussle with the Justice Dept. for \$210 million and dealing with the Securities & Exchange Commission over America Online's accounting ills, Time Warner “has achieved stability—and the financial flexibility to grow,” he notes. And it has slashed debt. Once burdened with huge financial woes, Time is producing lots of free cash flow, which Segal sees rising from \$4.5 billion in 2005 to \$5.2 billion in 2006, up from \$3.9 billion in 2004. Earnings before interest, taxes, depreciation, and amortization (EBITDA) should jump from \$10.7 billion to \$11.5 billion in 2006, he adds. What's restraining the stock, he says, is worry that Time may be overpaying with its \$17 billion bid for troubled cable outfit Adelphia Communications. But Segal

believes a deal will help Time expand its cable business. Segal sees Time merging the two cable properties and taking the unit public. This will become Time's vehicle to acquire other cable outfits, he adds. “For us, Time's rich cable properties enhance its allure as a turnaround play,” says Lewis Rabinowitz, a portfolio manager at C.E. Unterberg, Towbin, which owns shares. William Drewry of Credit Suisse First Boston, which has done business with Time Warner, figures Time will earn 76¢ a share in 2005, up from 69¢ in 2004. He rates it outperform.



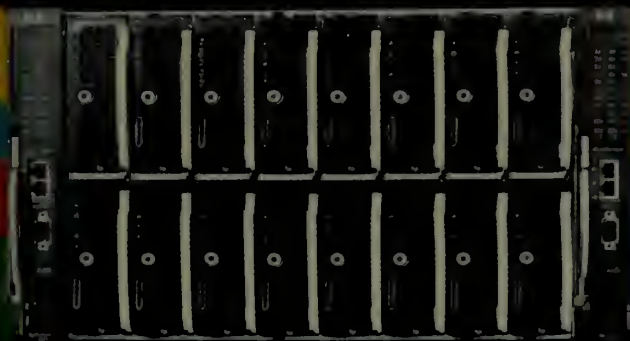
HealthTronics, a Urologist's Best Friend

SHARES OF LITTLE-KNOWN HealthTronics (HTRN) been on fire, bolting from 6.32 in October to 10.40 on Mar. 9. One hedge fund, with nearly 5% of the stock, has more room to run—to 20 in a year. HealthTronics is the largest provider of urological services, mainly for kidney stones, with 183 “lithotripsy” units in 47 states. Urologists use its lithotripters to deliver shock waves to break kidney stones into sand-like particles, which then pass through the urinary tract. HealthTronics also provides treatments such as lasers and cryosurgery for both benign and malignant prostate tumors. And HealthTronics makes specially equipped trucks to transport cardiac labs or CT scanners, as well as military gear. This year the company plans to sell this unit to put more funds in its medical operations. Anne Barlow of Southwest Securities, who rates HealthTronics strong buy, says in a recent report that the truck unit could sold for \$105 million to \$120 million. She expects earnings 53¢ a share in 2005 on sales of \$301 million and 74¢ in 2006 on \$341 million. ■



BusinessWeek online Gene Marcial's Inside Wall Street is posted at businessweek.com/today.htm at 5 p.m. EST on the magazine's publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor the firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.



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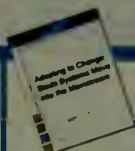


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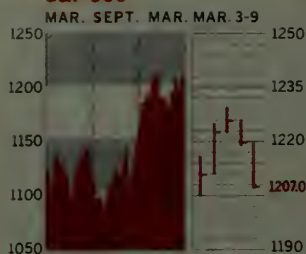


Numbering is not a measurement of higher performance. 2. Based on internal HP testing; compared to similarly configured HP1U, 2P server. For configurator, please visit: <http://h30099.www3.hp.com/configurator/catalog-issipc.asp>. and through 4/30/05. 4. Receive up to 2TB of storage free with purchase of select HP StorageWorks MSA1500 devices. Offer ends on 3/31/05. See Web site for full details. Intel, Intel logo, Intel Inside, Intel Inside Logo, Intel Centrino, Intel logo, Celeron, Intel Xeon, Intel SpeedStep, Itanium and Pentium are trademarks or registered trademarks of Intel Corporation or its subsidiaries in the United States and other countries. ©2004 Hewlett-Packard Development Company, L.P.

Personal Business Figures of the Week

STOCKS

S&P 500



COMMENTARY

A strong jobs report on Mar. 4 sent the Dow to a 52-week high, but that gain was gone by Mar. 9, when the Fed released its *Beige Book*. The report, showing that prices for goods are rising, fanned inflation fears. That worry, coupled with surging oil prices, sent stock and bond buyers rushing to the nearest exit. For the week, the indexes ended in negative terrain.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS

	MAR. 9	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	1207.0	-0.3	-0.4	5.8
Dow Jones Industrials	10,805.6	-0.1	0.2	3.3
NASDAQ Composite	2061.3	-0.3	-5.2	3.3
S&P MidCap 400	669.7	-0.4	1.0	10.7
S&P SmallCap 600	329.5	-0.8	0.2	15.7
DJ Wilshire 5000	11,884.1	-0.3	-0.6	6.6

SECTORS

			% CHANGE YEAR TO DATE	LAST 12 MONTHS
BusinessWeek 50*	722.5	-0.8	2.5	13.5
BW Info Tech 100**	361.4	0.1	-3.2	1.9
S&P/BARRA Growth	581.1	-0.3	-0.2	3.2
S&P/BARRA Value	621.5	-0.2	-0.6	8.4
S&P Energy	342.2	-1.6	18.6	43.0
S&P Financials	399.3	-0.3	-2.9	-0.9
S&P REIT	134.9	-0.7	-6.6	6.8
S&P Transportation	231.5	1.8	-4.1	24.0
S&P Utilities	147.3	0.0	4.0	19.5
GSTI Internet	158.1	-0.7	-11.4	13.6
PSE Technology	743.4	-0.7	-4.6	3.7

*Mar 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS

	MAR. 9	WEEK	% CHANGE YEAR TO DATE
S&P Euro Plus (U.S. Dollar)	1438.6	1.7	3.0
London (FT-SE 100)	4996.1	0.1	3.8
Paris (CAC 40)	4066.7	0.1	6.4
Frankfurt (DAX)	4375.6	-0.4	2.8
Tokyo (NIKKEI 225)	11,966.7	1.3	4.2
Hong Kong (Hang Seng)	13,941.5	0.7	-2.0
Toronto (S&P/TSX Composite)	9795.1	-0.1	5.9
Mexico City (IPC)	13,671.4	-0.7	5.8

FUNDAMENTALS

	MAR. 8	WEEK AGO
S&P 500 Dividend Yield	1.95%	1.95%
S&P 500 P/E Ratio (Trailing 12 mos.)	20.3	20.2
S&P 500 P/E Ratio (Next 12 mos.)*	16.5	16.4
First Call Earnings Revision*	0.47%	0.56%

TECHNICAL INDICATORS

	MAR. 8	WEEK AGO
S&P 500 200-day average	1146.1	1142.9
Stocks above 200-day average	76.0%	75.0%
Options: Put/call ratio	0.72	0.66
Insiders: Vickers NYSE Sell/buy ratio	4.74	4.49

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Oil & Gas Exploration	18.4	Fertilizers & Ag. Chems.	77.4
Divsfd. Metals & Mining	16.5	Oil & Gas Refining	73.8
Gold Mining	14.2	Steel	72.0
Oil & Gas Refining	11.5	Oil & Gas Exploration	61.7
Fertilizers & Ag. Chems.	11.2	Managed Health Care	50.8

WORST-PERFORMING GROUPS

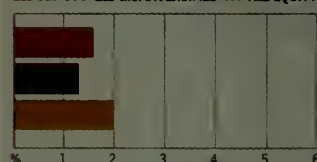
	LAST MONTH %		LAST 12 MONTHS %
Auto Parts & Equipment	-10.7	IT Consulting	
Commerical Printing	-8.7	Insurance Brokers	
IT Consulting	-8.4	Auto Parts & Equipment	
Automobiles	-6.4	Electric Mfg. Svcs.	
Biotechnology	-5.6	Semiconductor Equip.	

MUTUAL FUNDS

4-WEEK TOTAL RETURN

WEEK ENDED MAR. 8

■ S&P 500 ■ U.S. DIVERSIFIED ■ ALL EQUITY



52-WEEK TOTAL RETURN

WEEK ENDED MAR. 8

■ S&P 500 ■ U.S. DIVERSIFIED ■ ALL EQUITY



Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Precious Metals	14.8	Latin America	43.7
Natural Resources	12.4	Natural Resources	43.2
Latin America	7.2	Utilities	23.2
Europe	6.4	Europe	23.0
LAGGARDS		LAGGARDS	
Health	-1.9	Technology	-3.7
Technology	-0.9	Health	-1.3
Communications	-0.4	Precious Metals	2.9
Small-cap Growth	-0.3	Large-cap Growth	4.4

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
ProFunds Pr. Mtls. Inv.	23.6	ProFunds Oil & Gas Inv.	77.1
U.S. Gbl. Invs. Gl. Rscs.	20.6	BlackRock Gl. Res. Inv. A	62.0
ProFunds Oil & Gas Inv.	20.3	iShares MSCI Austria Idx.	57.6
U.S. Gl. Invs. Prec. Mnl.	19.4	U.S. Gbl. Invs. Gl. Rscs.	53.2
LAGGARDS		LAGGARDS	
PIMCO RCM Biotech. D	-13.0	Ameritor Investment	-47.1
ProFunds Biotech. Inv.	-11.0	Apex Mid Cap Growth	-32.9
Fidelity Advr. Biotech. B	-10.9	Ehrenkrantz Growth	-27.3
Fidelity Select Biotech.	-10.6	Van Wagoner Emerging Gr.	-25.9

INTEREST RATES

KEY RATES

	MAR. 9	WEEK AGO
Money Market Funds	2.09%	2.04%
90-Day Treasury Bills	2.75	2.73
2-Year Treasury Notes	3.65	3.51
10-Year Treasury Notes	4.52	4.38
30-Year Treasury Bonds	4.82	4.74
30-Year Fixed Mortgage †	5.80	5.82

†BankQu

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR
General Obligations	5.74	
Taxable Equivalent	5.30	
Insured Revenue Bonds	5.74	
Taxable Equivalent	5.41	

THE WEEK AHEAD

RETAIL SALES Tuesday, Mar. 15, 8:30 a.m. EST » February retail sales are forecast to have grown by 0.5%, following a 0.3% drop in January. That's based on the median estimate of economists surveyed by Action Economics. Excluding vehicles, sales most likely posted a 0.6% gain for a second straight month.

BUSINESS INVENTORIES

Tuesday, Mar. 15, 10 a.m. EST » January inventory levels

most likely expanded 0.4%, after a 0.2% rise in December.

CURRENT ACCOUNT

Wednesday, Mar. 16, 8:30 a.m. EST » The U.S. current-account deficit probably swelled to \$181.8 billion during the final quarter of 2004. In the third quarter, the shortfall widened slightly to \$164.7 billion.

INDUSTRIAL PRODUCTION

Wednesday, Mar. 16, 9:15 a.m. EST » February industrial

output is expected to have risen by 0.3%, after holding steady in the previous month. The average monthly operating rate likely edged up to 79.1%, after slipping to 79%.

EXPORT-IMPORT PRICES

Friday, Mar. 18, 8:30 a.m. EST » February export prices probably increased 0.3% and import prices most likely grew 0.6%. During January, export prices jumped by 0.7% while import prices surged by 0.9%.

The *BusinessWeek* production edged up to 237.6 for the week of Feb. 26, a gain of 11.4% from a ago. Before calculation of the week moving average, the eased down to 237.9.

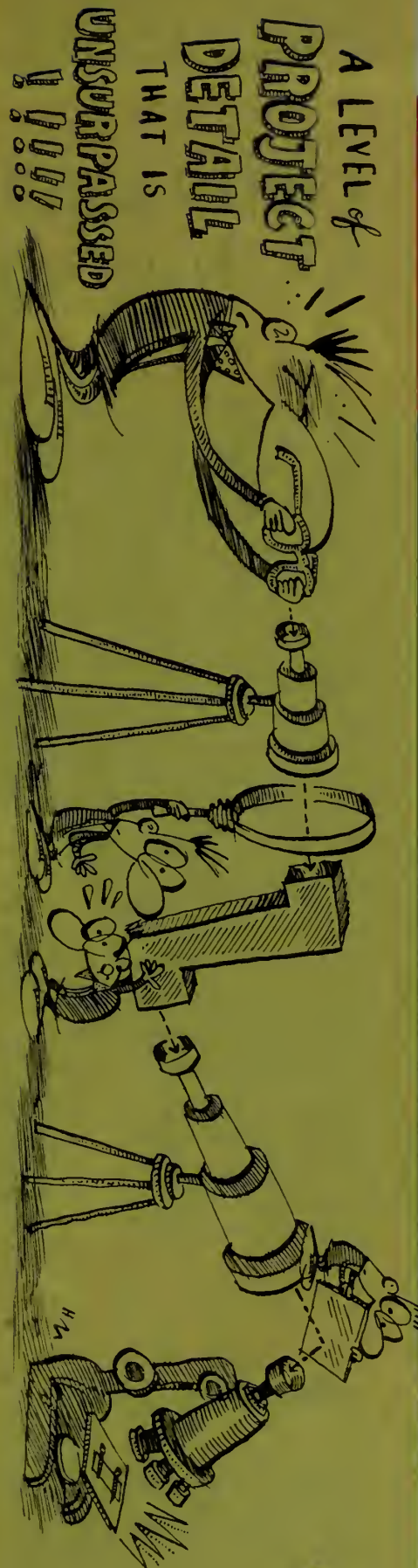
BusinessWeek onl

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/magazine/ex

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Getting an Edge On Innovation

OUTSOURCING IS PROVING to be a far greater challenge to America than anticipated. Not only are companies sending their low-cost production and services to Asia, but they are also shipping much more of their research and development overseas. What were once considered core competencies for high tech and other companies are now becoming inexpensive global commodities. Chip design, mechanical and electrical engineering, testing, software writing, and high-tech manufacturing are heading to India, China, and Eastern Europe. Indeed, a large chunk of the nation's existing knowledge economy is migrating, along with many high-paying jobs (page 84). Neither Corporate America nor Washington is prepared for this vast change in the U.S. economy. It's time to get ready.

Companies such as Procter & Gamble, General Electric, Johnson & Johnson, and Motorola are at least beginning to transform their cultures and reshape their business models by moving beyond the 1990's Six Sigma focus on quality and cost. They are focusing on high-impact innovation that targets consumers, who increasingly want their products and services tailored to their individual needs. These companies no longer just spend broadly on R&D and toss the latest high-tech gizmos at people. They try to first unearth the

Companies must decide which ideas are best kept close to home

unarticulated needs and wants of buyers and then satisfy them. The goal is to create special, differentiated experiences using proprietary brands. Such out-of-the-box innovation may be the best path to top-line revenue growth and fat profit margins.

But it's hard to make elephants dance. This business strategy requires a skill set very different from managing the old Six Sigma way. Companies are discovering that they need different talents,

compensation systems, and goals to organize this kind of enterprise. Implementing this magnitude of cultural change can be wrenching.

Companies also must decide where they draw the line on outsourcing. In a world that keeps commoditizing core technologies and skills, it takes sophisticated strategic thinking to determine what intellectual property to keep and what to farm out. If too much innovation is outsourced, corporations may find their own suppliers competing with them. One thing is certain—understanding the consumer zeitgeist requires a cultural intimacy that cannot be delegated elsewhere. Intellectual property that enhances customer experience should be held close. Choosing what to let go will be painful.

But not as difficult, perhaps, as redesigning America's education system. Colleges are still graduating mechanic and electrical engineers who can no longer compete against equally competent but lower-paid Indian, Hungarian, and Chinese rivals. America's schools and universities must step up to the next level in math and science. And far more people should be graduated in the "soft" sciences of anthropology, sociology, and psychology. Whether it's redesigning hospitals to improve patient stays (and lower costs) or building stores to increase the experience of shopping (and raise profits), more of these "right brain" people will be needed. Many of the best jobs in the future will be found in the sweet spot where design, customer understanding, and emerging technologies come together for business.

Globalization is moving so fast that now even the knowledge economy is being redistributed around the world. A whole new set of winners and losers will appear in the ahead. Corporations and the nation have work to do if they are not going to be left behind.

Boeing Needs A New Board, Too

BOEING CO. IS IN TROUBLE again. Yet another scandal is sweeping through the company, forcing its second chief executive out of office in 15 months and setting off a fierce internal battle for power. The same board of directors that has overseen Boeing through years of ethical and sexual misconduct is now choosing another CEO. At the very least, the board should strongly consider going outside the company to bring in someone who can clean up Boeing's troubled corporate culture and end the constant, brutal, bureaucratic infighting (page 34). The board might consider replacing much of its members as well. It has done a rather poor job of watching out for shareholders' long-term interests.

Look at the record. Airbus has pushed Boeing aside for the No. 1 spot in the commercial jet market. A series of legal problems in Washington has sullied Boeing's name in Congress and cost the company billions in potential government military contracts. Boeing employees used documents from rival Lockheed Martin Corp. to win a contract for launching military rockets. This led to a 20-month ban on Boeing bidding for future launches. The ban was lifted just days before the latest scandal erupted. Boeing still faces problems on other launch contracts with NASA. And the company is still dealing with a violation of federal conflict-of-interest laws that led to the cancellation of a multibillion tanker refueling deal. Chief Financial Officer Michael Sears lost his job, pled guilty to criminal charges, and was sentenced to prison.

Before he was fired, Stonecipher managed to stabilize the company and repair its image in Washington. But Boeing's problems run deep. An outside CEO and a new board should return it to its straight-arrow engineering roots.

March 28



SCIENTISTS
THEY SEE
THE FUTURE (P.88)

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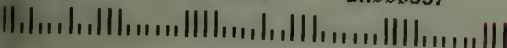


THE DIGITAL HOSPITAL

BY TIM MULLANEY AND
ARLENE WEINTRAUB

(P.76)

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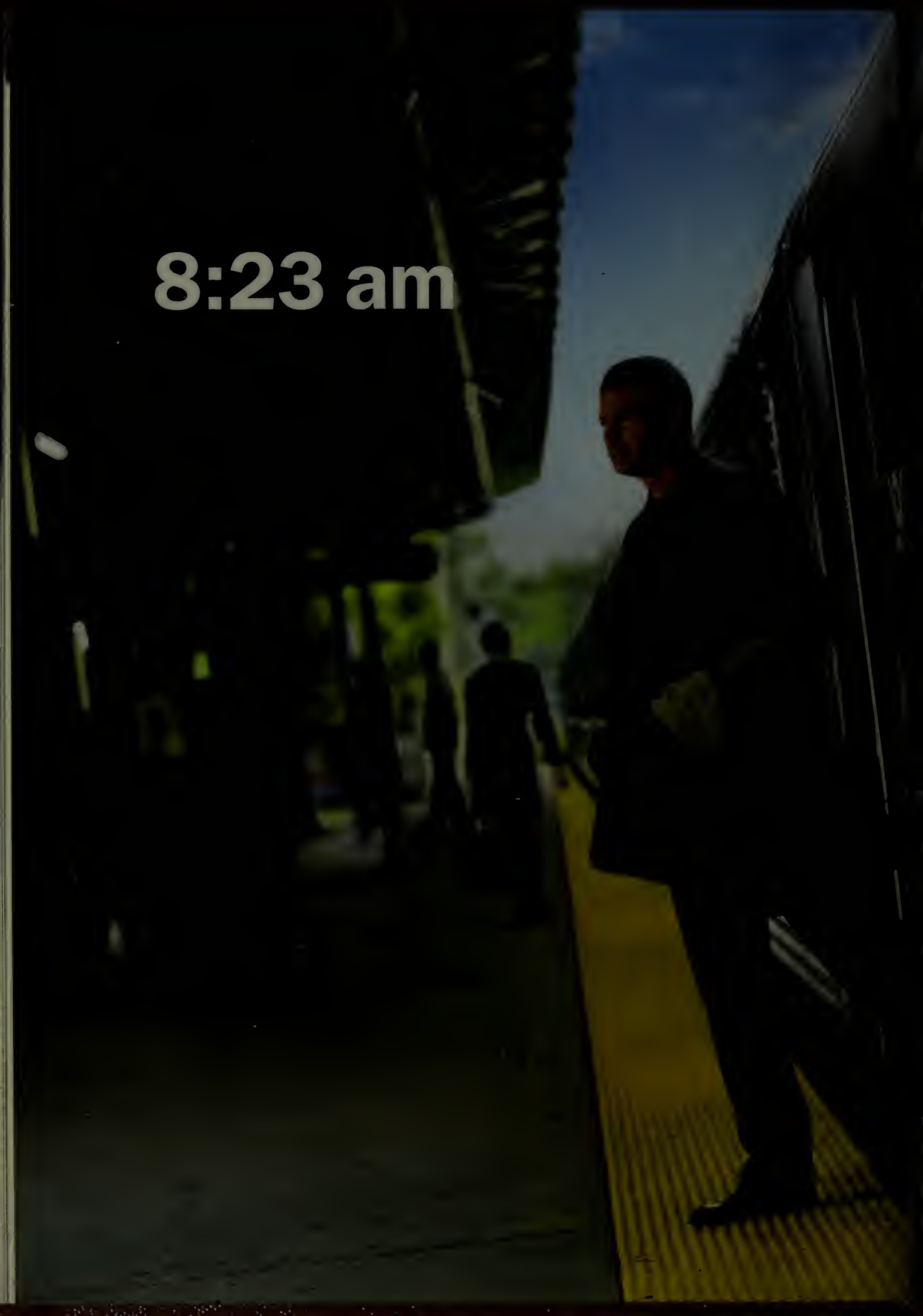
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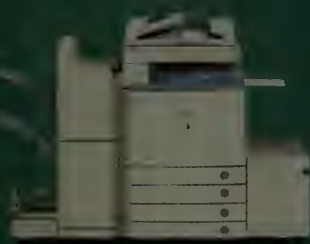
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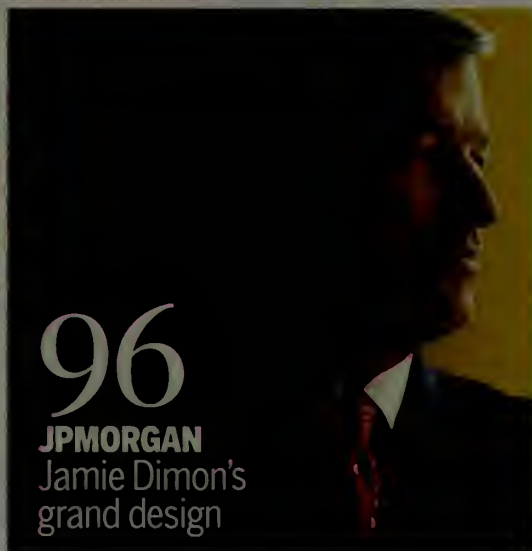
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When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

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Investing in Real Estate—Without Getting Burned

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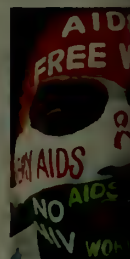


Oil's Rise Isn't the Economy's Fall

According to Standard & Poor's Chief Economist David Wyss, thanks to a series of changes put into place since the last oil shocks, energy prices would have to go a lot higher before pushing the U.S. toward recession

India: Economic Success Threatened by AIDS

By most measures, India is booming. But economic stats aren't all that are soaring. So too are HIV-positive cases, but many won't acknowledge the urgency and extent of the danger



Big Software's Blood Sport

The battle between Oracle and SAP over Retek, a small software developer that has carved out a niche with retailers, reveals some uncomfortable truths about the info-tech business's basic instincts

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"His personality is friendlier than Greenberg's."

—AIG board member Eli Broad on the company's new CEO, Martin Sullivan

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UGFESTS ASON CKETS COURT

MS Kenneth Langone avoid controversy. The of investment firm ed Associates is on the of data broker Choice- which was recently d into giving criminals s to its database of con- ers' personal information. n Mar. 8, Langone and cePoint settled suits viving data purveyor y Asher, founder of info -Seisint. Asher alleged gone trashed him and nt to potential buyers so cePoint l snap it up e cheap. r, an tted former runner, ed Langone bidders e books were ed' [and] Seisint was by 'bad ple,'" says uit. Asher Seisint to sNexis for \$ million. choicePoint Asher also ed charges in her suit ning that er violated a compete pact

TV SUITS Langone he GE board

by starting Seisint after ChoicePoint bought an earlier company of his.

Meanwhile, nine suits have been filed against ChoicePoint, execs, and directors, alleging securities laws violations involving false information about the status of the company. One issue is the timing of stock sales by CEO Derek Smith and President Douglas Curling. The ChoicePoint board discussed plans for the pair to sell stock for a \$16.6 million profit after the security breach was discovered by some execs but before it was made public. The two say they were unaware of the breach at the time.

Langone, who heads the governance committee, says he, too, was unaware of the breach. A Langone spokesman says the stock sales were O.K.'d by a compensation committee on which Langone doesn't serve.

Langone is already embroiled in a suit over his role as a former director of the NYSE and ex-head Richard Grasso's \$188 million pay package. On Feb. 8, Lagone resigned from GE's board to devote his energy to defending against the suit.

—Brian Grow



MISMATCHES

Pulling Up Stakes In Lands' End?

IS LANDS' END UP FOR SALE? With Kmart Holding's \$11 billion acquisition of owner Sears Roebuck expected to close at the end of March, potential buyers believe so. Former Lands' End CEO Michael Smith says that he has been approached about heading the company by three different private equity groups interested in acquiring the purveyor of casual clothes. "There is at least the expectation that it is going to be on the block," says Smith, who declined to identify the investment firms.

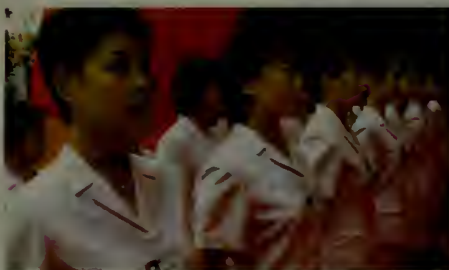
In 2002, Sears paid \$1.9 billion for the cataloger. But Lands' End has done poorly in Sears' stores, and its catalog sales have fallen, too—by mid-single digits in 2004. UBS Securities analyst Gary Balter estimates Lands' End could fetch \$1 billion to \$1.5 billion—money Kmart Chairman Edward Lampert could use to pay down his \$6.2 billion debt or buy back stock. A spokesman for Lampert declined to comment.

Investors would be attracted to the brand and prospect of operating the catalog better. Smith says he passed because the quality and brand have suffered under Sears. "It's going to be a real project to turn around." On Feb. 22, Sears slashed 375 Lands' End jobs. Housecleaning before a sale? —Robert Berner

GENDER WATCH

NOW NO MEANS NO IN CHINA

THE PHRASE “sexual harassment” didn’t exist in the Chinese language a decade ago. Now lawmakers are hoping to eliminate the act-



ions it describes. On Mar. 4, female Communist Party leaders introduced legislation to make sexual harassment illegal.

The problem has become widespread in China as more women join the workforce. In

REDRESS A women’s bank staff in China

a recent newspaper survey, 86% of women say they have been hassled by co-workers. In 2003, male officials in Sichuan Province were barred from having female assistants in order to curb incidents.

There is no specific law under which victims can get redress, so most sexual harassment suits in China are dismissed. The only two plaintiffs to win cases—one a man—did so by citing a law protecting their “human dignity.” Each got \$250 and an apology.

The proposed law—expected to be enacted in July—also would compel companies to prevent workplace bad behavior. Of course, changing mind-sets is harder than changing laws.



CAR TALK

IN THE SHOP Auto makers and buffs love “cars”—the dream vehicles companies build cast a glow across their lineup. Think Dodge Viper. But what happens when the halo disappears? Ford’s \$143,000, 550-horsepower GT supercar harks back to the race car that beat Ferrari at Le Mans in 1996. Alas, the GT has been walloped into the pit repeatedly since its October, 2002 debut. The car has been plagued by two recalls and at least six repair notices, ranging from faulty fuel tanks to seat belt flaws. Worst was Ford’s “do not drive . . . under any circumstances” in December, warning owners of a defect that could cause a loss of steering control. Buyers seem to consider it the price of owning an icon—GTs sell for up to \$100,000 over sticker price.

—Kathleen Koy

UNION BLUES

WHAT DISORGANIZED LABOR WANTS

MANY HIGH-TECH and other professional workers want a collective voice in their workplace—just not a traditional labor union. A poll presented at a recent conference put on by the **AFL-CIO’s** Professional Employees Dept. (DPE) found the union goal of winning better salaries and benefits was a low priority.

The poll canvassed 1,200 nonunion nurses, tech workers, and university faculty. The message, says DPE head Paul Almeida, is “labor needs to reshape itself with new models of organization like associations” to reach professionals.

—Aaron Bernstein

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FACE TIME

DONALD TRUMP



MY KIND OF TOWER, CHICAGO IS

Who's afraid of high living? Not **Donald Trump**—or at least, not anymore. The celeb developer just signed off on his final plans for Trump Tower Chicago, a condominium/hotel that now will soar to 1,360 feet and rank second only to Chicago's Sears Tower as the tallest building in the Western Hemisphere.

Never known for subtlety, Trump originally planned a 150-story tower that, at up to 2,000 ft., would have been the world's tallest. But within weeks of September 11, he halved the height, to 78 stories and 1,073 ft., recognizing that few people would want a home in what might become a new terrorist target.

Those fears apparently are over. With plenty of people putting down deposits, Trump has upped the tower to 92 floors and planted a 235-ft. spire on top, putting it within 90 ft. of the Sears Tower. "I like height," says Trump. "It gives you the view. It gives you the drama. It gives you the architecture." And, of course, more buyers.

—Michael Arndt

NET THREATS

NEW SHARKS IN THE WEB SURF

THE PERILS OF a high-tech world keep getting worse. Spam is growing more sophisticated. Viruses plague PCs. And cell phones, PDAs, and voice-over-Internet protocol (VoIP) networks, used to make inexpensive calls over the Web, are being targeted by hackers. Now even more insidious threats may be on their way.

■ **Pharming** It's a new twist on "phishing," where e-mails from fake banks and credit-card companies try to entice Web surfers to give up their passwords. Pharming plants malicious code on users' computers by e-mail. So when they visit a trusted Web site and are least likely to expect a scam, the malcode goes to work logging keystrokes—or delivering fake pop-up windows that appear as if they're from that Web site—to pilfer personal data.



In the past month, says security firm **Proofpoint**, pharms known as "Banker" and "Goldun" have surfaced. Last year, "Korgo" hit 4,000 U.S. Web surfers, says the **SANS Internet Storm Center**.

■ **Bluesnarfing & Bluebugging** Exploiting Bluetooth, the wireless standard that links cell phones and headsets, is the new craze. A fairly benign version called "bluejacking" involves sending text messages to unwitting owners of cell phones and PDAs.

The latest variant: sending viruses, or bluebugging.

Users in the U.S. and Europe have been hit. The problem could get worse. On Monday, Finnish security firm **F-Secure** identified "Commwarrior," the first virus that can spread through Bluetooth and phone networks. What's next? Bluesnarfing: hijacking the cell phone and PDA.

Halting this new onslaught of hackers may be tough. Says Gary Steele, head of Proofpoint:

"Whether it's e-mail, VoIP, or the Web, they'll come after you." In a digital world, there's no place to hide.

—Brian



MEDIA WATCH

TONIGHT'S SPECIAL GUEST DIABETIC...

TV NEWS programs often run segments on diseases such as AIDS. But now a weekly show on **CNBC** will be devoted to a disease: diabetes. **dLife Media** is producing *dLife*, a 30-minute show on Sundays at 7 p.m. starting on Mar. 20.

Some 15 million Americans have diabetes, with diagnoses growing about 10% a year. The key to

getting a disease its own show, says **dLife** CEO Howard Steinberg, a diabetic, is advertisers with tangential interest. Diabetics have special skin-, oral-care, and dietary needs. **Colgate-Palmolive** (oral care), **Atkins Nutritionals** (low-carb food), **Beiersdorf** (skin care), **Becton Dickinson**, and **Novo Nordisk** (diabetes supplies and drugs) are sponsors.

The show's hosts all have diabetes. Besides news, features, and interviews, Steinberg says celebrity guests will "come out" as diabetics on the show.

—David Kiley

THE STAT

25

The percentage of workers who say they "are just showing up to collect a paycheck." Only 14% say they are very satisfied with their job.

Data: Conference Board's Feb. 28 Job Satisfaction Survey of 5,000+ workers

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“China’s numbers simply do not add up... Decisions that businesses make built on faulty data could spell disaster.”

—Robert B. Cassidy
 Washington



PRESSURE IS MOUNTING TO REVALUE THE YUAN

“WHO WANTS the yuan to rise?” (News: Analysis & Commentary, Mar. 7) got it wrong. The National Association of Manufacturers has not “pulled out” of the campaign to address Chinese currency manipulation. In fact, the goals of NAM’s 2005 China Trade Policy Agenda are an immediate revaluation of the currency. Although we withdrew support for a formal complaint against China, we did so only because the Administration had made clear that such a filing would be immediately rejected as counterproductive. Rather than commit resources to a filing that was to be rejected, we have vigorously waged this battle on many other fronts.

—John Engler, CEO
 National Association of Manufacturers
 Washington

THE TRADE DATA released by China’s government continue to be misreported, giving corporations a false sense of security and preventing governments and international organizations from making sound decisions. China estimates, for example, its 2003 surplus with the U.S. as \$63 billion, while the U.S. has tallied China’s surplus

(U.S. deficit) at \$124 billion. But it’s the U.S. Similar differences exist for countries: China reports a \$22 billion plus with the European Union, while data reflect \$57 billion; Japan, an \$11 billion deficit, vs. Japan’s calculation that it has a \$14 billion surplus with Canada, a \$1 billion deficit, vs. a \$10 billion surplus. Simply put, China underestimates its surplus with all partners.

Using their data to compute the U.S. surplus, with appropriate adjustments made for transshipments through Hong Kong and transportation charges, China’s global surplus based on third-party partner data was estimated at \$22 billion in 2003, compared with China’s estimate of \$25 billion. Do the math: China’s numbers simply do not add up. Investment and other decision-making by U.S. businesses made based on faulty data could spell disaster. Economists estimate the degree of undervaluation of the yuan, which realistically is off by as much as 40% when calculated on the basis of trading partner data.

Multinational companies have suffered through a number of currency crises: the peso crisis in 1994, the Argentine peso crisis in 1997-98, and the

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BusinessWeek

MARCH 28, 2005 (ISSN 0007-7135) ***

3926

Published weekly, except for one week in January and one in August by The McGraw-Hill Companies, Inc. **FOUNDER:** James H. McGraw (1860-1948).

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POSTMASTER: Send address changes to BusinessWeek, P.O. Box 53235, Boulder, CO 80322-3235. Periodicals postage paid at New York, N.Y., and at additional mailing offices. Canada Post Publication Mail Agreement Number 40012501.

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CORRECTIONS & CLARIFICATIONS

Harvard's lessons in management," (Editorials, Mar. 7) should have referred to Lawrence H. Summers as one of the longest tenured professors in Harvard University's history, not the youngest.

A fund thrives in Cleveland" (Personal Business, Mar. 21), Victory Diversified Stock Fund's losing year was 2002 (not 2003), and the loss was in line with the Standard & Poor's 500 Stock Index.

in 1998. A yuan/dollar crisis would be far more serious than any of these, having a much more dramatic impact on global trade and finance. What is needed is a soft landing. This can be achieved if the Chinese act swiftly, with the support of the U.S. and the EU.

—Robert B. Cassidy, Director
International Trade & Services
Collier Shannon Scott PLC
Washington

or's note: Previously, the writer was U.S. Trade Representative for China, Hong Kong, and Taiwan.

FREE TRADE MAY UNDERMINE AMERICAN VALUES

THE ARGUMENT FOR free trade was a classic bait and switch ("States' rights vs. trade," Government, Mar. 7). The ini-

agreement was eminently logical. Nations would remove all "artificial barriers to trade. "Artificial barriers" were widely understood to mean tariffs and subsidies. Now the word "artificial" is gone, and our basic values are under attack as "barriers" to free trade.

This means "free trade" nations must adjust to the lowest common denominator of values. It is time to rethink this deal.

—David L. Hagan
Pismo Beach, Calif.

THE RIGHT RESPONSE TO THE MAD COW

"MAD COW'S stubborn mystery" (Science & Technology, Mar. 7) *BusinessWeek* notes that even some within the National Cattlemen's Beef Assn. agree that further research is "urgently needed." This is followed by a quote from me that says: "We should follow the science." *BusinessWeek* used my statement incorrectly. I was referring to a significant body of research that shows beef is safe from "mad cow."

—Gary Weber
Executive Director, Regulatory Affairs
National Cattlemen's Beef Assn.
Centennial, Colo.

"MAD COW'S stubborn mystery" mentions the U.S. Agriculture Dept.'s commitments to "meatpackers and ranchers who want access to Canadian cattle." Nothing could be further from the truth. The Ranchers-Cattlemen Action Legal Fund, United Stockgrowers of America (RCALF-USA), with more than 10,000 members, of which I am one, has been fighting to keep the border closed to protect the American public from possible contaminated beef from Canada since the Agriculture Dept. proposed reopening the border.

On Mar. 2, RCALF-USA gained a temporary restraining order preventing the border from opening until a full hearing could be held. Not all cattle ranchers want to gain access to Canadian cattle. Some of us want to protect ourselves and the U.S. consumer from problems from over the border until all pertinent issues have been discussed.

—Kirby Walborn
Hardin, Mont.

TO KEEP GROWING, EUROPE MUST WELCOME ASIANS

NO MATTER HOW MANY reforms European countries may introduce to become more competitive in the fast-growing global economy, they would still lag behind and continue to face lackluster growth unless they become more open to accepting highly skilled immigrant workers and students from India, China, and other Asian countries ("Every little reform counts," International Business, Mar. 7). That would not only require reforms in their economic and immigration policies, but far more profound changes in the perceptions of Europeans toward foreigners.

—Srinivas Balla
Fairfax, Va.

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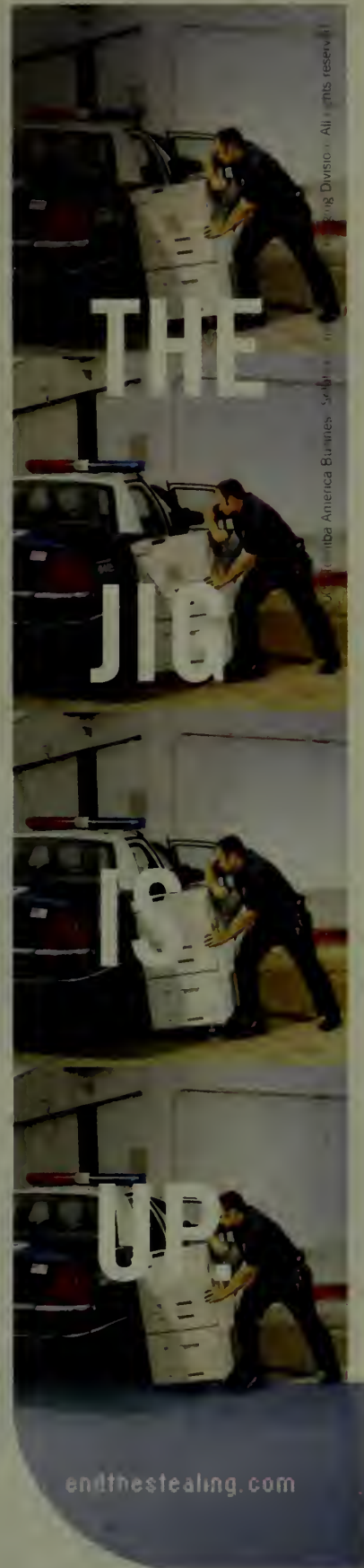
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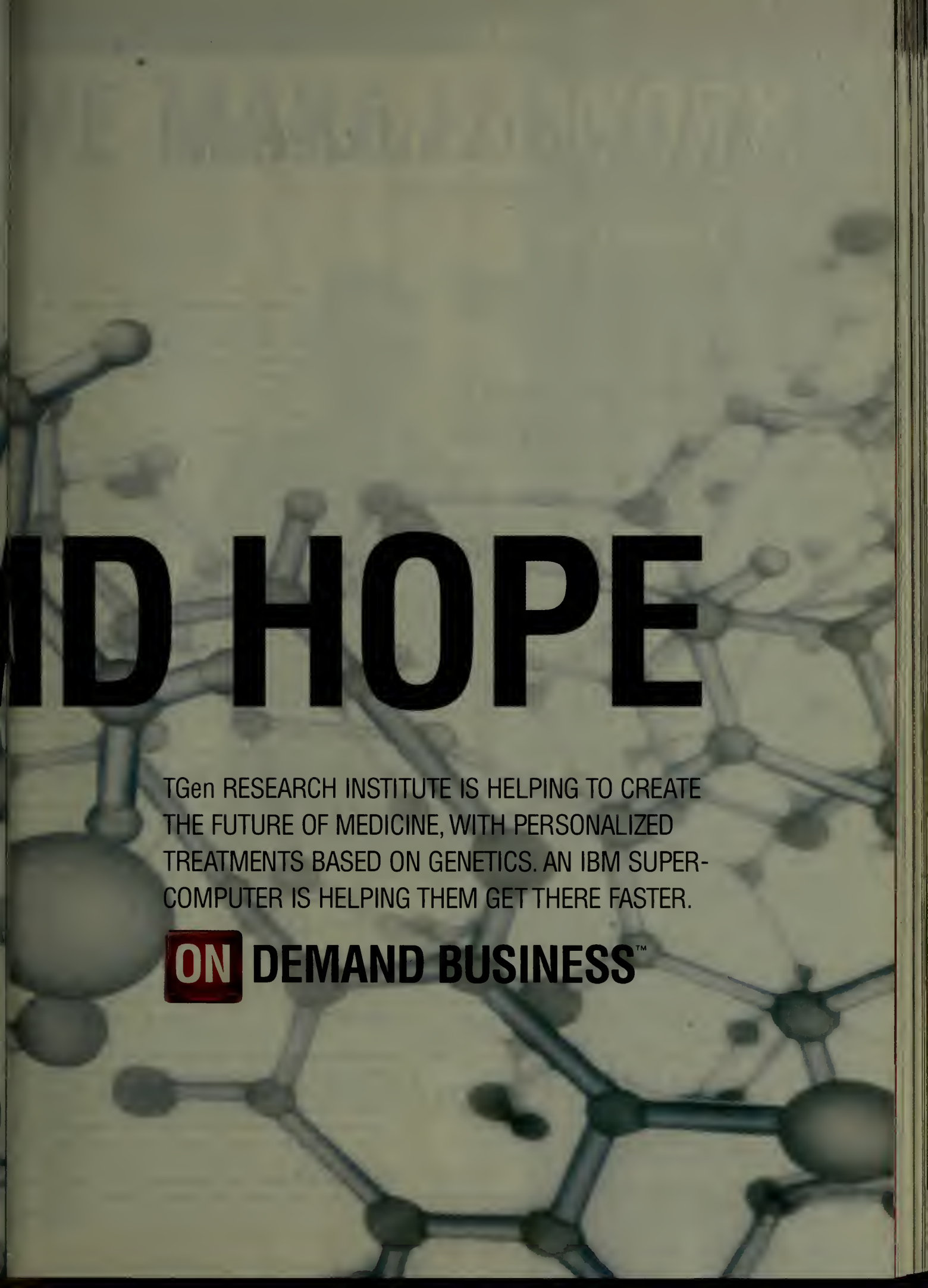
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Hollywood Confidential

THE BIG PICTURE The New Logic of Money and Power in Hollywood
By Edward Jay Epstein; Random House; 396pp; \$25.95

In 1937, Walt Disney Co. made history with the release of *Snow White and the Seven Dwarfs*. The first full-length animated film produced in the U.S., it was derided by many movie moguls as folly, since Disney had expended vast resources on a film catering largely to children. But time would demonstrate

Disney's sagacity, which extended far beyond the question of audience. For *Snow White* was also the first movie to have tie-in merchandise and its own soundtrack album. In short, the movie was just one part of the enterprise.

The model first divined by Walt Disney 70 years ago is what now defines the entertainment business. Today's Hollywood is built around ancillaries, from video-game spin-offs to boxed DVD sets and theme songs offered as cell-phone ring tones. The evolution of the modern marketing- and brand-driven global media giants is meticulously documented by Edward Jay Epstein in *The Big Picture: The New Logic of Money and Power in Hollywood*.

Epstein captures the sweep of an industry over the past half-century by using a variety of devices, from historical profiles to anecdotes to financial tables on the players. In illustrating the industry's changes, he provides an enlightening tour of what he calls the "sexopoly"—Viacom, Fox, NBC Universal, Time Warner, Sony, and Disney. *The Big Picture* lacks the magnetic narrative of other great Hollywood business books, such as David McClintick's *Indecent Exposure*. And in a volume that's rich on analysis of Tinseltown's bottom line, one might want a bit more on the thorniest issue facing studios now, digital piracy. Still, Epstein's taut chapters are absorbing.

The author is no novice in chronicling business. His 12 earlier books include *Dossier: The Secret History of Armand Hammer* and *The Rise and Fall of Diamonds: The Shattering of a Brilliant Illusion*. In *The Big Picture*, Epstein explains why so many studios—seemingly aping Disney—are channeling their resources into big, special-effects-driven fantasies with licensable characters and targeted at juvenile audiences. The Hollywood executives of the 1990s, Epstein writes, had good intentions, wanting "to help produce movies that would measure up to the ones they and those around them had admired—such as classic films directed by Frank Capra, Howard Hawks, John Ford, and Alfred Hitchcock." Even now, many seek to maintain some level of prestige through smaller, much less profitable films that are developed by studios'

independent arms. However, Epstein points out, the cost of making these indie films has risen drastically, to a million apiece in 2003, adding to studio losses and giving executives pause. In the end, it's the kid flicks that win.

The costs and logistics of modern moviemaking provide Epstein with some of his richest material. For example, Russell Crowe's face was scanned into a computer and digitally placed on the faces of several of the 79 stuntmen used in the movie *Gladiator*. It took eight months of expensive computer wizardry to make it appear to be Crowe in all scenes. But under the terms of special insurance that both inside and outside financiers demand to cover a film's "essential elements," stars are mostly not allowed to do their own stunts, lest an injury delay production. Indeed, insurers shy away from some actors: After Nicole Kidman sustained a knee injury in 2000, the producers of *Cold Mountain* had trouble getting coverage for her. They succeeded only after

she agreed to put \$1 million of her own salary into an escrow account that would be forfeited if she failed to maintain the production schedule.

The author also digs deep into Hollywood financial schemes. For instance, Arnold Schwarzenegger "lent" his services to *Terminator 3*. His pay of \$29.25 million went instead to the actor's company, Oak Productions Inc., a maneuver that allowed Arnold to avoid certain tax liabilities.

The Big Picture takes the reader beyond the balance sheet with chapters on Hollywood's political and social influence. In one anecdote, Epstein recounts how, during the late 1990s,

the White House Office of National Drug Policy Control worried that movies were having a harmful effect on public attitudes. So, the agency pressured studios to insert antidrug themes into film scripts—their executives reviewed them to make sure the message was coming through.

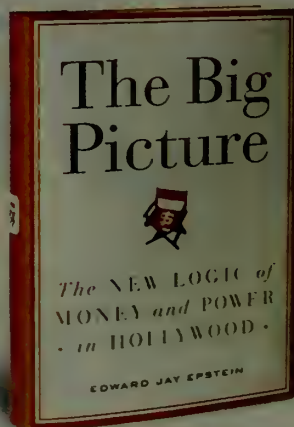
Such tidbits make Epstein's failures all the more striking. He notes that technology is

transforming the way movies get delivered, but he never reflects on the dark side of tech—the possibility of a sequel to the disaster that gutted music sales. Intellectual-property theft is clearly a front-burner issue for every studio:

According to some industry estimates, as many as 600,000 copies of films are being downloaded illegally every day.

For anybody who is a film buff, *The Big Picture* will be an adventure. But once you learn what goes on behind the scenes, you may never again look at a movie the same way.

—By Tom L.



The industry relies on juicy spin-off deals way more than movies

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Unfortunately, some of the most serious security threats come from the people you trust most. Whether it's accessing e-mail from unsecured mobile devices or remote connections, employees, contractors or business partners can introduce viruses and other digital menaces that can wreak havoc on your network. Protect yourself with Insight's broad product offering and Secure IT solution portfolio. We combine the leading security technologies along with a wide range of services and expert resources to help you defend against the enemies you know and the ones you don't. Let us help you make IT safer.



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BY STEPHEN H. WILDSTROM

Coming Soon: Mobile Couch Potatoes

In an age of monster plasma screens, the idea of watching television on the tiny display of a wireless phone seems odd. But cell phone video has already found an audience in some markets, notably Korea and Japan. Now, with better networks and handsets, it's coming to the U.S.—and the surprise is that it can be fun.

This is especially true with V CAST service from Verizon Wireless. It's based on Verizon's superfast BroadbandAccess network, which is available in 30 metropolitan areas and will roll out to most other major markets by the end of the year. A typical "program" on V CAST is a clip of two minutes or less. Offerings include news from CNN, sports from ESPN, and weather from AccuWeather. You can watch miscellaneous movie trailers and other entertainment briefs, including an assortment of *Sesame Street* clips. There's even original programming, most notably *24: Conspiracy*, a mobile spin-off of Fox's hit suspense series, *24*. V CAST is billed as a \$15 surcharge on a voice plan. There are also extra-cost services, including NBA TV and nascar.com to go, sold by the clip, and a variety of games.

I tried V CAST on an LG VX8000 (\$200 with a two-year service contract). At a bit under 4 oz., it's bulkier than many high-end phones but has a 2-in. diagonal display. Since the display is much higher than it is wide when the phone is held normally, you have to rotate the handset 90 degrees to watch a full-size video image. The service uses the first phone technology capable of delivering video that approaches broadcast-TV quality, albeit on a small screen. One triumph is that when people are speaking onscreen, the audio is in reasonably close sync with the video—still rare on phone-based TV. The phone also includes a 1.3-megapixel camera that can take stills or 15-second videos.

A DRAWBACK OF THE VX8000 and V CAST is the awkward controls for video. Just getting to a listing of *24: Conspiracy* episodes and other shows took 14 clicks of various buttons. But once you're in the right menu, the phone takes advantage of the fast network to load clips with minimal delay. Verizon offers two other V CAST phones, the Samsung A890 and the

LG'S VX8000 It's bulky, but has a big screen



Audiovox CDM8940: Both cost \$250 with a service plan.

Verizon's network deserves much of the credit for V CAST's superior performance—a point that became apparent when I compared V CAST with Sprint TV. Sprint and Verizon use similar wireless technology from Qualcomm. But V CAST uses a new version, called 1xEVDO, that can consistently transmit at 300 kilobits per second, while Sprint's older 1xRTT service runs at 50 to 60 kb/sec. Sprint is installing an EVDO network and plans to begin service later this year.

The Sanyo MM-5600 (\$249 with activation) that I used for Sprint's video service is a bit smaller than Verizon's LG phone, but comes with similar specifications. While its display is about the same size, it doesn't offer a full-screen mode, so the images aren't a lot bigger than a postage stamp. And even at that smaller size, which requires less data, the pictures are less sharp and a lot jerkier than on V CAST.

Verizon's service lets you watch CNN, ESPN, and 24 on your cell

Sprint's phone menus are easier to use, but its pricing is a lot more complicated than Verizon's. The Sprint TV package, which includes company calls basic cable for your phone, costs \$10 above a voice plan and includes new sports from ABC, Fox, and ESPN. Then there's an assortment of premium programming, most for \$5 a month, featuring CNN, MTV, and Music Choice videos, and a

miscellany of original content called mFlix, including two minutes of an animated frog telling dreadful jokes.

To achieve commercial success, mobile-video services need a network at least as good as Verizon's EVDO and more compelling content. That's likely to happen. But even the current offerings can be appealing. I wish I'd had a phone that showed *Sesame Street* when my kids were little. ■

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BY LAURA D'ANDREA TYSON

What Larry Summers Got Right

In his controversial remarks about the underrepresentation of women in engineering and science, Lawrence H. Summers, president of Harvard University, argued that top leadership positions in academia, business, and law require a time commitment that many women are unwilling to make. In both the U.S. and Europe several high-profile cases of successful women

quitting their jobs seem to confirm his view that women are choosing to opt out of high-powered jobs. The opt-out hypothesis could explain why, according to a recent U.S. survey, 1 in 3 women with an MBA is not working full-time, vs. 1 in 20 men with the same degree. Today many companies are recruiting female MBA graduates in nearly equal numbers to male MBA grads, but they're finding that a substantial percentage of their female recruits drop out within three to five years. The vexing problem for businesses is not finding female talent but retaining it.

HOW LARGE IS THE OPT-OUT PHENOMENON, what are its causes, and what can companies do to retain talented women? A fascinating article by Sylvia Ann Hewlett and Carolyn Buck Luce in the March issue of *Harvard Business Review* provides some answers to these questions. The article summarizes the results of a carefully designed survey of highly qualified women and men—defined as those with a graduate degree, a professional degree, or a high-honors undergraduate degree. Individuals with such educational attainments are likely to have outstanding career opportunities and to have considerable talent to offer employers. But as the survey reveals, a large percentage of such highly qualified women do indeed choose to take time off from their careers, and they pay a huge price in terms of future job opportunities and financial rewards to do so.

Some 37% of the women surveyed—and 43% of those with kids—voluntarily left work at some point in their careers, with the average break lasting about two years. In contrast, only 24% of the men took time off from their careers, with no statistical difference between those who were fathers and those who were not. Some 44% of the women cited family responsibilities as the reason for their leaving, compared with only 12% of the men. Among men, who averaged about one year off, the primary reason was career enhancement. The survey results also confirm the pervasiveness of the traditional division of labor within families. Despite the fact that the education gap between women and men has all but disappeared, women in most families are still expected to shoulder the lion's share of caring for children, for elderly parents, and for spouses.

But 93% of the women who took time off from work wanted

to return to their careers, despite the painful work-life trade-offs required. Unfortunately, only 74% of those were able to do so, with 40% returning to full-time professional jobs and taking part-time positions. And even those who returned to the workforce lost substantial earning power, with the penalty becoming more severe the longer the break. Overall, women who took time out from careers lost an average of 18% of their earning power; in business careers, the average loss was even higher, at 24%, even though the average break lasted little more than a year.

Such reductions in earnings potential are a primary cause of the earnings gap between men and women of comparable education levels increases during child-bearing and rearing years. The survey also found that many women cope with

family trade-offs by working part-time, reducing the number of hours they work in full-time jobs, and declining promotions.

What should employers do to retain highly qualified women? The survey results indicate that women value jobs with reduced hours and flexible work arrangements. Women are less likely to opt out of work if their employers offer flexible career paths that allow them to ramp up and ramp down their professional

Yes, many women opt out of the workplace. What can business do?

responsibilities at different career points.

Larry Summers was on to something when he speculated that many women are unwilling to make the time commitment required to attain leadership positions in demanding professions. But as the presidents of Stanford, Princeton, and Massachusetts Institute of Technology—whom are women with children—argued in their responses to Summers' comments, the status quo is neither inevitable nor desirable. Employers can and should develop cultures and specific policies to strike a better balance between the demands of work and the demands of family. ■

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JAMES C. COOPER & KATHLEEN MADIGAN

Time to Wave Goodbye to a 'Measured' Pace

In an economy this strong, the Fed might need to hike rates faster

U.S. ECONOMY In the Federal Reserve's brave new world of policy transparency, words are often more important than deeds. Openly graphing the intention to change policy has become standard operating procedure at the Fed. That's why the news coming out of the policy meeting on Mar. 22 will not be the widely expected hike

interest rates but the language in the accompanying statement. Based on the way the economy is shaping up this year, the current policy message is bound to change—if not at the upcoming meeting, then soon. Otherwise, the Fed risks being perceived as out of step with its long-term goal of containing inflation.

Since last May the markets have come to expect the Fed's statement to say that the bank plans to lift rates at a "measured" pace. That leisurely sounding phrase is usually interpreted to mean a quarter-point hike at each meeting until policymakers feel that rates have reached a neutral level that neither helps nor hinders the economy. The drag on growth from surging oil prices might give the Fed some room to maintain its gradual pace.

However, given the economy's surprising vigor and rising signs that the inflation outlook may not be as bleak as it appeared a few months ago, the current language locks the Fed into a commitment that could be inappropriate, especially if demand and pricing power continue to be greater than expected.

Indeed, the economy's strength is partly the result of the Fed's own decision to accommodate growth for so long. Its nearly unprecedented easy policy has supplied liquidity to the financial markets and provided cheap mortgages for home buyers. Heavily indebted businesses had a chance to refinance, which has lowered costs and generated more cash for investment.

Now that wages and salaries are growing at a healthy pace and corporations are awash in cash, the Fed must get the economy off these cushy financial conditions. In this new era of communication, the Fed will want to prepare the financial markets for the fact that policy may have to move faster than expected. The first step will be a change in the policy statement.

NEW WORD ORDER from the Fed would most likely be a "measured" pace. The resulting more hawkish tone would jar the markets, at least temporarily. That's because a new statement would mean policymakers want the flexibility to lift rates by more than a quarter point, if necessary, based on what the economic numbers show. Certainly, the latest data portray an economy with more muscle than the Fed probably anticipated at the

start of the year. The bond market has taken notice and has pushed long-term rates sharply higher (chart). Consumers keep shopping, even in the face of higher oil prices. Homebuilding remains strong. And businesses are busy, expanding production and building inventories.

Retail sales rose 0.5% in February, and the revised January numbers show a sales gain of 0.3% instead of the

0.3% loss previously reported. Stronger job markets explain much of the upward climb in demand. But another factor is record consumer wealth. According to Fed data, household net worth—total assets minus liabilities—hit a high of \$48.5 trillion at the end of 2004.

Businesses are also in better financial shape.

And they are finally contributing to growth—by much more than they have so far in this expansion. Companies boosted their inventories by a large 0.9% in January. Inventory-building should offset the worsening trade deficit that looks to be the only serious drag on the first-quarter economy. In February, homebuilders broke ground at an annual rate of 2.2 million new homes, a two-decade high. And industrial production advanced 0.3%, the fifth gain in a row, while factory output rose 0.5% for the third consecutive month.

From the Fed's viewpoint, robust industrial activity is a potential cause for concern. U.S. industry used 79.4% of its available capacity in February, up from 78% last September (chart, page 26). At that pace, operating rates by early next year would be at a level typically associated with production constraints and inflationary pressures.

IN FACT, it is becoming increasingly apparent that two years of above-trend economic growth is reducing the slack in both the product and labor markets. Such a trend typically leads to a shift in inflation dynamics. In its own Beige Book summary of regional economic conditions,

A CHANGE OF HEART IN THE BOND MARKET



the Fed noted that increased cost pressures in the production pipeline are translating into increased pricing power. "A number of districts indicated greater ease in passing along price increases," the report said.

The bond market already senses a change in both economic reality and Fed urgency. Bond players seem to be coming around to the notion that the exceptionally low yields on the benchmark 10-year Treasury bond in recent months are out of sync with economic realities. Perceptions of growth, inflation, and Fed policy began to shift in early February amid a spate of strong data. Fed Chairman Alan Greenspan's musing during his February testimony that low bond yields amid Fed tightening were a "conundrum" also helped to shake the market out of its stupor.

From Feb. 9 to mid-March, the 10-year yield has risen from less than 4% to more than 4.5%, and fixed mortgage rates have jumped close to 6%. The rise may have further to go. Bond yields are still below the peak of nearly 4.9% hit last June. With gasoline prices rising rapidly—nearly touching last year's record of \$2.06 per gallon on Mar. 14—the March and April price indexes will not look good. Even excluding energy and food, yearly core inflation rates at both producer and consumer levels are on an upward-creeping course.

CONSEQUENTLY, THE FED may also have to reevaluate its statement on the risks for future inflation. Since last May policymakers have said that the upside and downside risks to price stability have been "roughly equal." That balance may be shifting, to a large extent,

because the Fed's exceptionally low interest rates provided a key support to overall demand. And strong demand is why economic slack is dwindling.

Moreover, unit labor costs, a key determinant of inflation, are starting to pick up now that product growth has slowed. In the final three quarters of last

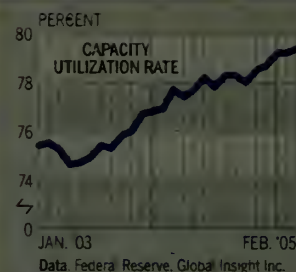
year, unit costs rose at an annual rate, the fastest in nearly four years. The pressure to raise prices to at least meet that higher pace of inflation will be especially high in service industries, where labor is the dominant cost and where price power tends to be weaker.

To be sure, inflation expectations remain anchored, and that's a big reason

why bond yields have not shot up. However, it's important to remember that expectations are formed from actual inflation experience. If actual inflation really continues to rise, so will expectations.

The new question confronting the Fed is this: How should it take policy to neutral? Recent data on growth and inflation hint that the central bank is moving too slowly. If that's true, then given the lags inherent in policy adjustments and the Fed's desire to act preemptively, any change in the policymakers' intentions will need to come soon.

INDUSTRIAL CAPACITY IS GETTING TIGHTER



FRANCE

Stumbling Over the High Euro and Oil

AFTER PUTTING IN a solid showing at the end of 2004, France's economy may be shifting into a lower gear.

French real gross domestic product rose by 0.8% in the fourth quarter, propelled by good gains in consumer spending, public outlays, exports, and capital investment. Within the euro zone, the French increase stood in sharp contrast to the declines in real GDP posted by Germany and Italy.

But early 2005 data show some slowing of momentum. Industrial production was up by only 0.2% in January over December as auto and energy production declined. The trade sector remained in the red, with a deficit of 931 million euros (\$1.2 billion) in January. Then in

February retail sales dropped 1.3%, giving back about a third of the 3.9% jump in January, when biannual store discounts brought out shoppers. And business confidence fell last month.

Amid such weak news, the Bank of France on Mar. 14 cut its first-quarter forecast for the second time in a month. The BOF now expects real GDP growth of 0.4%, down from 0.5% in February and 0.6% earlier.

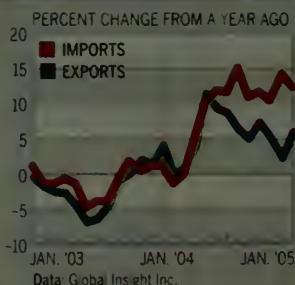
What's behind the slowdown? Pricier oil, a strong euro, and slack labor markets are all big factors. Oil and the euro have had sizable impacts on the trade front. Because of higher prices, imports of energy products jumped 21.5% in 2004. The sharp deterioration in the trade of energy

products accounted for three-fifths of the swing in France's trade balance from a 1.58 billion euro surplus in 2003 to an 8.2 billion euro deficit in all of 2004. At the same time, the stronger euro is curtailing the gains in exports. Plus, weaker growth in Germany is hurting French sales of goods to its largest trading partner.

Domestically, consumer demand will be held back in the first half of 2005 not just by higher fuel costs but also by a sluggish labor market. The jobless rate in January stayed at 9.7%, higher than the euro zone's average of 8.5%.

While no one is worried about a drastic slowdown in France, the loss of momentum makes it more likely that the European Central Bank will hold off on lifting interest rates. Policymakers want to see evidence of sustainable growth among the members of the euro zone. But the latest news on the French economy did not offer any such clues. ■

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TROT

RUNNING OUT OF GAS

With market share and sales falling fast, a bloated GM needs to shrink to make money

ON MAR. 10, GENERAL Motors Chairman and Chief Executive G. Richard Wagoner Jr. hopped on the company jet with his chief financial officer and some sales execs to visit dealers in Dallas on the West Coast. The idea of the was to shore up morale—and, more important, to get some answers to the nagging question of why GM can't pump market share and wean buyers off fuel-eating incentives. One Texas dealer says Wagoner was extremely upbeat, saying that some of GM's new and upcoming models and a new advertising campaign would turn things around. Less than a week later, Wagoner was decidedly less ebullient. On Mar. 16 he

and CFO John M. Devine stunned Wall Street with a warning that GM's flagging sales will result in a huge hit to the bottom line in 2005. With market share sliding in the first two months of the year, from 27.2% for 2004 to 24.9%—the lowest level since a two-month strike shut the company down in 1998—GM as a whole expects a net loss of \$846 million in the first quarter.

Like more and more companies these days, GM relies increasingly for profits on its financing arm (see page 32). But while General Motors Acceptance Corp. (GMAC) is expected to earn close to \$2.5 billion this year, significant losses in the auto unit could come close to wiping that number out. The company says it could earn as little as \$600 million in 2005, down sharply from \$3.6 billion

last year. Some analysts think even that figure is optimistic. As investors fled the stock, pushing it down 14% on Mar. 16, to 29, a somber Wagoner told investors and analysts: "We have to address some long-standing fundamental problems with the company."

NO REBOUND IN SIGHT

HE DOES—AND FAST. It's becoming painfully obvious that Wagoner's four-year-old strategy of using rebates to grab market share and generate cash has failed. Company insiders say the 52-year-old CEO is getting heat from the board, and some mid-level managers are losing faith the top brass will make the bold moves needed to execute a quick turnaround. Without a dramatic rebound in sales—an unlikely prospect anytime soon—GM may

be forced to shrink the company to a size that more closely matches its diminished market share. Wagoner may have to go back to the United Auto Workers to get concessions to trim his workforce and lower health-care costs. He will also have to squarely face a dilemma that has haunted GM for years: Can it really continue to support eight competing divisions? "GM is simply too big," says Sean McAlinden, chief economist at the Center for Automotive Research. "They have to shrink."

That's something Wagoner has been loath to do. For three years he has tried to stave off market-share losses by boosting sales incentives and selling more cars to rental fleets. At first the gamble seemed to make sense. Since union contracts force GM to pay workers at least 75% of their take-home pay when they are laid off, Wagoner figured he might as well have them working.

By selling more cars, even at lower margins, GM would preserve its customer base. More important, that was the only way GM could generate enough cash to pay its huge retiree obligations. The idea was to slog along until 2008, when the company's retiree population is projected to start declining. By then, Wagoner & Co. reasoned, the company's new lineup of cars, sport-utility vehicles, and trucks also would be out, allowing GM to pull back on profit-eating incentives.

Things haven't worked out as planned, though. Wagoner's strategy is dependent on GM at least maintaining the market share of roughly 28% it has



WORKERS GALORE
Wagoner would need UAW concessions to trim the labor force

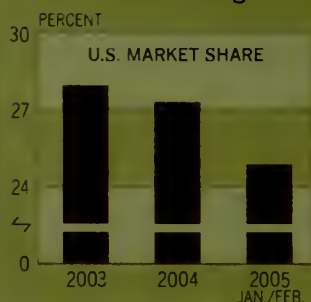
held in recent years, plus some growth in the auto business. But industry sales are off 5% from their 2000 peak of 17.4 million vehicles. What's more, amid rising gasoline prices, sales of large SUVs are slumping. As one of GM's strongest markets, that segment has been crucial for both sales and profits. Full-size SUV sales are off more than 20% this year, and

GM's Chevrolet Tahoe sales are down 30%. Meanwhile, sales of the company's new passenger cars—the Pontiac Vibe, Buick LaCrosse, and Chevrolet Cobalt—are too sluggish to pick up the slack.

Add it all up, and GM's finances still look very precarious. Dropping two percentage points of market share may sound like a big deal. But in GM's

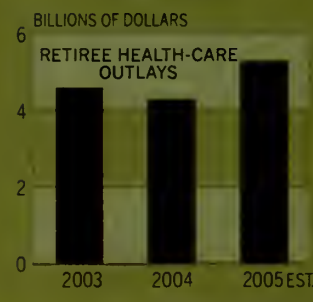
PEDAL OFF THE METAL

With GM's sales sliding...

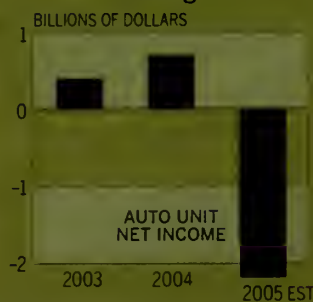


Data: General Motors Corp., Merrill Lynch & Co., Bloomberg Financial Markets

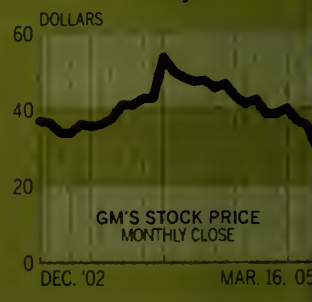
...as legacy costs climb...



...earnings are tanking...



...and its stock is way off



With eight brands, GM is simply making too many similar vehicles

a small shift makes a huge difference because it can't cut its costs to match the sales drop. In addition to paying huge sums for idle workers, its health-care costs for retirees are growing. As a result, estimates Deutsche Bank analyst Rod Lache, each percentage point of market share means roughly \$1 billion in lost profits to GM's North American operations.

That's not all. GM's European operations are expected to lose \$500 million a year. There also will be some one-time charges coming from GM's ongoing restructuring in Europe. The upshot, says Merrill Lynch & Co. analyst John S. Hines, is that the global auto business will lose \$2.2 billion this year. That means that GM overall could earn less than \$300 million.

APPEARING DIVIDEND

STEEP LOSSES in the auto unit also mean that GM will have negative cash flow. GM puts the shortfall at \$2 billion. While that will be offset by a \$2 billion dividend that the GMAC finance arm will pay to GM, the company must pay \$1 billion to Fiat to get out of its relationship with the ailing Italian carmaker. And that the fact that GM will take a charge for restructuring its European operations, and the company is starting to tap into its \$23 billion cash hoard.

What must GM do to turn itself around? Many analysts argue that Wagoner & Co. need to come to terms with the reality that maintaining market share of 25% is unlikely over the long term. Consider that fewer than two-thirds of GM's sales are retail. The rest go to rental agencies or to company employees and their families—sales that provide higher gross margins. Take those sales and reduce them to the lower levels of the Japanese sell—and analysts figure GM's sustainable market share is closer to 10%. Says Center for Automotive Research's McAlinden: "GM would be a wonderfully profitable company at 18% market share."

Even if GM is willing to accept what many believe to be inevitable, getting

there will be extremely difficult. GM's worsening woes could give it the leverage to wrest concessions from the United Auto Workers, and talks between management and union leaders have begun. The union will never waive the sacrosanct clause that makes GM pay laid-off workers, but it may be willing to compromise if the company offers something in return. GM, for instance, could negotiate a buyout package similar to the one it got from its German union last fall, when its Opel subsidiary cut 12,000 jobs. That could allow GM to shed jobs without adding to its fixed costs. The move is proving pricey in Europe and would be in the U.S., too, but the one-time charge would give way to lower labor costs later.

Another option: Persuade UAW workers and retirees to pay more of their health-care costs. Two years ago construction-equipment maker Caterpillar Inc. got the UAW to sign off on a deal that has their retirees and workers paying more than \$80

a month for insurance now and more than \$100 a month in coming years. GM workers currently pay nothing. If GM's 340,000 union retirees paid \$100 a month toward their health-care premiums, GM would save \$410 million a year. Since the UAW is in the middle of a four-year labor deal that expires in 2007, GM would need to go back and negotiate any concessions. Wagoner says that with most of GM's high-impact cost-cutting options, "we aren't contractually allowed to do it unilaterally." But, he added, "we will work with them."

Then there's the issue of size. GM's eight brands—among them Buick, Chevrolet, and Pontiac—collectively sell five front-wheel-drive midsize family sedans. And Saturn has a sixth coming out next year. Four of its divisions sell a minivan. The result: GM is simply making too many similar vehicles in a market awash with more and more models.

Moreover, since GM has so many models, the company can't redesign them all as often as rivals do. It took nine years be-

fore the auto maker replaced the Chevrolet Cavalier with the Cobalt, which arrived this year.

By contrast, Honda Motor completely redesigns the competing Civic every five years. Last year the average model on a showroom floor had been on the market for three years. But GM's average model had been selling for 3.7 years, says Merrill Lynch. From 1999 to 2004, GM replaced 76% of its sales volume with new models, but the Japanese auto maker replaced 113% of its volume. In other words, GM isn't making enough hot new models to get buyers into the showroom.

Wagoner has begun to unload some of the company's excess baggage. He announced the shuttering of Oldsmobile in 2000. He has closed four assembly



WAGONER
He'll soon be facing negative cash flow

plants and, since 1998, dropped the hourly payroll to 111,000 from 151,000, mostly through retirement. And top executives have at least discussed the notion of paring down GM's portfolio of brands, though that is a costly and difficult option that few see happening anytime soon. While Buick is on the list, it is one of GM's premium brands in China, so it is unlikely to be closed. If GM decides to cut a brand, Saab and Pontiac would top the list.

In the end, Wagoner and his team may have little choice but to put pride aside and start chopping. Few analysts expect GM to reverse its performance and regain share in the short term. "GM doesn't have many products that are hot right now," says Global Insight Inc. analyst John Wolkonowicz. "And there isn't much coming that will turn it around." Only by scaling its size and ambition to match its shrinking market share can GM hope to regain some of its luster. ■

—By David Welch
in Detroit

EARNINGS

CORPORATE AMERICA'S NEW ACHILLES' HEEL

Overreliance on profits from finance units may be setting companies up for a fall

AMERICA IS NO LONGER a nation of manufacturers. But it isn't quite a health-care or even a tech economy, either. Instead, America is quietly and quickly becoming a nation of financiers. Finance supplies 30% of all U.S. company profits, as of last Sept. 30, up from 21% a decade ago, according to federal government data. And some of those profits don't come from banks or other financial companies, but from manufacturers and retailers that rely on their financial activities for a big chunk of their earnings. At Deere & Co., the farm-equipment company, finance produces nearly one-fourth of earnings. Retailer Target Corp. usually gets about 15% of its profits from its credit cards. And while General Motors Corp. is having trouble selling cars, its ditech.com mortgage business is going great guns. GM's financing operations earned \$2.9 billion last year, while GM lost money on cars. If GM earns any money this year, it will again come from finance.

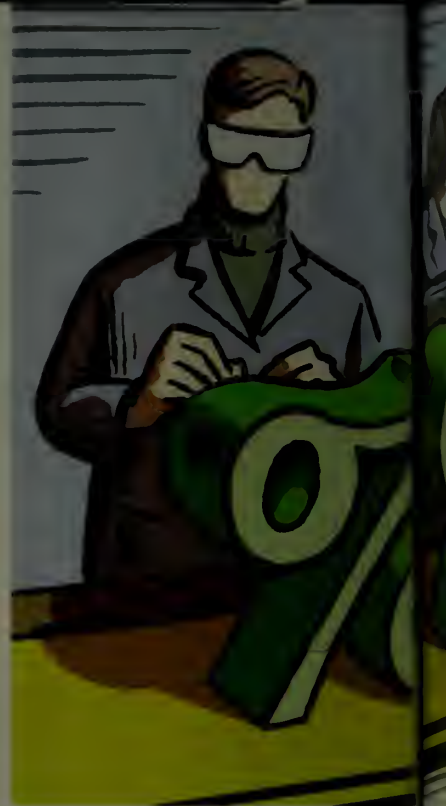
With finance dominating the corporate landscape, any threat to financial earnings has a magnified impact—and now several threats are gathering. Since the Federal Reserve started raising interest rates in June, finance businesses have paid higher short-term rates on the funds they use to make loans, but the rates they charge customers for longer-term loans haven't been rising nearly as fast. That's starting to squeeze profits.

What's more, lenders have been running more

risks than ever as the competition for borrowers heats up, according to a report by Bridgewater Associates Inc., which manages \$92 million in investments. So more defaults may be on the horizon. Meanwhile, auditors and regulators are applying accounting rules more strictly, which could dent the reported profits of some finance operations. This has already happened at mortgage giant Fannie Mae and at insurers MBIA Inc. and RenaissanceRe Holdings Ltd. "As a result, you'll see much slower earnings growth for Corporate America," says David A. Rosenberg, chief North American economist at Merrill Lynch & Co. In fact, Standard & Poor's expects earnings at financial-services companies in its S&P 500-stock index to grow just 6% this year, down from the 27% jump in 2003.

PROFIT ENGINE

INDEED, SLOWING GROWTH in financial earnings threatens to break a three-year streak of double-digit profit growth for S&P 500 companies. The financial sector—which doesn't include the finance arms of manufacturers and retailers—has



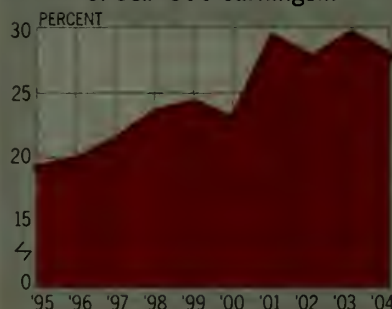
become the biggest engine of profit for the S&P 500, contributing 28% of earnings by companies in the index last year. By contrast, the next two most significant sectors, health care and information technology, kicked in just 12% and 11%, respectively, while industrial companies ponied up 10%. Ten years ago, financial companies provided 19% of earnings. At the same time, earnings from finance have become dramatically important for many nonfinancial companies. General Electric Co.'s finance and insurance units kicked in 49% of its \$1.5 billion profit last year, up from 37% in 1995. Last year, H&R Block Inc. earned \$678 million in pretax profits from mortgages—more than it did from tax return preparation. A decade ago, financial services were even a tenth of Block's revenues.

The trend is sobering for the stock market. That's because Wall Street tends to pay lower prices for a dollar of finance earnings than for a dollar of lesser quality than profits. GE, mindful of this, is paring back by selling most of its lower-return insurance businesses. Chief Executive Jeffrey Immelt has said he still expects 40% to 45% of earnings to come from commercial and consumer finance units.

Sometimes the impact

FINANCE RULES

Financial companies produce the biggest share of S&P 500 earnings...



Data: Standard & Poor's, company reports

...and that doesn't count the finance profits of manufacturers

COMPANY	SHARE OF 2004 EARNINGS
FORD	103%*
GENERAL MOTORS	103*
GENERAL ELECTRIC	49
DEERE	22
CATERPILLAR	19

* Finance earnings exceeded overall earnings



ance business on the bottom line is
ult to ferret out. Electronics retailer
it City Stores Inc., for example, does
disclose how much money it makes
selling extended warranties on its
ucts. But analysts estimate that the
pany would have lost money in the
ended February, 2004, if it didn't of-
warranties. The company says it gives
ropriate" information.

he most obvious threat to this earn-
parade is the sharply
rowing gap between
t- and long-term inter-
rates that market
ens call the spread.
April the spread be-
n the 2-year and 10-
Treasuries—used as
hmarks for pricing fi-
re deals—was an ex-
tionally high 2.4 per-
age points. It's now
n to 0.8 point, making
ing much less prof-

than before. "Financial institutions
feel that," says James W. Paulsen,
f investment strategist at Wells Cap-
Management.

f course, financial companies now
late themselves better from interest-
changes with derivatives and by
kly packaging loans and selling
n to hedge funds and other institu-
tional investors. That way they earn
e in fees for arranging the transac-
and collect less in interest pay-
ts. Financial companies now get

about 42% of their revenues from fees
and only 58% from interest, compared
with 20% and 80%, respectively, in
1980, according to Bridgewater.

Maybe so. But with thinner margins,
there could well be fewer loans on
which to collect fees. That's what would
happen if the spreads were too narrow to
attract institutional investors, who bor-
row short-term money to invest in
longer-term paper in what's called the

From rising rates to defaults, business faces a slew of threats

"carry" trade. "Client after
client tells me these trades
carry well, but they're going
to carry less well in coming
months," warns Merrill
Lynch's Rosenberg. The
most noticeable impact
could be on mortgages,
says Peter Thiel, president
of Clarium Capital Manage-
ment LLC, a hedge fund
that is betting that the
housing market is about to
crack. That's because mort-

gages are now the biggest part of the
U.S. debt market.

Rising rates also hurt financial com-
panies because the risk of loans going
bad increases. These days, lenders are
especially vulnerable to defaults as they
have become a lot less choosy about
whom they lend to. Credit analysts at
Moody's Investors Service are predicting
an increase in defaults of junk bonds to
3.2% of issuers over the next year, from
2.5% as of last month. They also foresee
a significant risk that companies will not

be able to refinance junk bonds maturing
over the next three years when a glut of
exceptionally low-quality debt comes
due. Home mortgage debt, too, has been
climbing faster than home prices the
past four years.

CREATING A CHILL

RISING RATES AND defaults always
pose a risk to finance profits, but now
there's a third hazard: tougher scrutiny
of accounting practices by regulators
and auditors. Last fall regulators uncov-
ered a plethora of accounting maneuvers
at Fannie Mae allegedly aimed at dress-
ing up its earnings. Fannie's results are
now undergoing wholesale restate-
ments. On Mar. 15 an investigation into
whether American International Group
Inc. distorted its results resulted in the
resignation of its longtime CEO, Maurice
R. Greenberg. Regardless of whether
AIG broke the law or must report lower
earnings for past periods, the case likely
will prompt executives at other financial
companies to be more conservative in
tallying their numbers.

Of course, it's possible that none of
these scenarios will turn into painful re-
ality. Perhaps stronger demand from
borrowers will lift long-term rates and
spreads. Perhaps the recent buildup of
cash on corporate balance sheets will off-
set losses from defaults. In an economy
that increasingly revolves around fi-
nance, however, the triple threat is cer-
tainly unsettling. ■

—By David Henry in New York

COMMENTARY

BY DEAN FOUST

Keeping a Grip on Identity

How to hold info brokers accountable for security without fouling up commerce

VENKATESH “BUNTY” Pabbaraju’s heart sank when he received the letter in early February. ChoicePoint Inc., the giant information broker, was warning him that a California fraud ring had gained access to his private financial data. It wasn’t the first time the 43-year-old Atlanta resident had been on the wrong end of a scam: Less than a year

earlier, someone had swiped his identity and run up \$7,000 in unauthorized charges on one of his credit cards. While nothing like that has happened this time—so far, at least—Pabbaraju is furious that brokers like ChoicePoint could put him at risk again. While ChoicePoint says it was itself a victim of fraud, Pabbaraju says: “It’s distressing that they could sell my data to two-bit criminals. There ought to be a law.”

He may be right. If one thing became clear after the security breach, it’s how little oversight government has to ensure that information brokers such as ChoicePoint adequately protect the financial data of millions of Americans. As if to hammer that home, on Mar. 9, Reed Elsevier Group PLC’s LexisNexis unit disclosed that hackers had gained access to roughly 32,000 of its consumer accounts. And no one doubts that identity theft is a growing problem. In 2004, according to the Federal Trade Commission, there were 246,570 complaints of identity theft, up from a mere 1,380 in 1999. And the FTC in 2003 estimated that annual losses from such fraud stood at about \$47.6 billion.

After the recent mischief, Congress has begun to pay attention. On Mar. 15 two congressional committees held hearings, during which several potential fixes were floated. They included giving the FTC regulatory authority over the information brokers, allowing consumers to restrict access to their personal information, and forcing data brokers to notify consumers when their information is compromised. But in the face of intense industry opposition, strong regulation is unlikely to materialize soon—if ever.



Dear Venkatesh S Pabbaraju:

I'm writing to inform you of crimes committed against ChoicePoint that may have resulted in Personally Identifiable Information such as your name, address or Social Security number being viewed by businesses that should not have accessed such information.

Upon learning of fraud against the company, we discontinued these customers' access to this information and worked with law enforcement authorities. As you may be aware from recent

That’s not simply stonewalling. Finding the right balance between securing private data without irrevocably harming an industry that provides a vital service will be tricky. Data collected by ChoicePoint and its ilk allow financial institutions to make loans, landlords to assess the credit histories of prospective tenants, and employers to check out potential hires. Fines levied against information brokers too hard, and conducting business would become less convenient and more expensive. Consumers could find it slower and tougher to get access to credit.

But there are ways to protect consumers without restricting the industry too harshly. For starters, Congress should follow the leads of California and Texas and allow individuals across the country to place a “security freeze” on their credit history. Since a freeze makes it hard for merchants and other providers of credit to review an applicant’s credit history without permission, it would become nearly impossible for thieves to make an unauthorized application for credit. While industry lobbyists contend that freezing and then unfreezing data is more cu-

GROWING SCOURGE



Data: Federal Trade Commission

ome than consumers realize—and I deprive them of credit and other opportunities—ultimately people should have the right to choose whether the extra security is worth the additional hassle.

Washington lawmakers also should pass national legislation similar to the 1999-year-old California law that requires information brokers to notify all residents in the state whose data file has been compromised. Without such a law, the data firms are unlikely to do so voluntarily. After all, according to California authorities, ChoicePoint didn't alert consumers when it

suffered a similar incident in 2002. ChoicePoint has declined to discuss the incident. The only reason Pabbaraju got the

TWICE BITTEN Scammers got to Pabbaraju via ChoicePoint

bad news this time was that the California law forced ChoicePoint to send letters out to the 35,000 Californians whose information was compromised, and attorneys general from other states demanded similar disclosures for the rest of the nation. Industry lobbyists fret that automatic notification could create needless hysteria among consumers. After all, they argue, most security failures don't result in financial fraud. Perhaps, but better to know enough to start monitoring your credit than remain in the dark when someone has the information needed to try to steal your bank account.

The information brokers also should have greater liability when a breach occurs. Up to now, courts have refused to allow defrauded consumers to bring lawsuits against brokers like ChoicePoint. The reason: Since individual consumers don't have a business relationship with the brokers, they have no legal standing without the threat of fines or other financial penalties, the brokers have little economic incentive to beef up their security. Bruce Schneier, chief technology officer of Counterpane Internet Security Inc., a Mountain View (Calif.) security company, notes that originally in Europe, consumers were liable for any credit card fraud unless they could show their bank was at fault. As a result, ATM security in Europe remained lax. It didn't improve until regulators started holding banks liable for customer losses, as was already the case in the U.S. "That's what regulation does," says Schneier. And given the difficulty information brokers have in policing themselves, that may be what's needed once more. ■

BANKING

Forget Those Comfy Old Rules About Fraud

Way back when most banking transactions were conducted at a teller window or with a checkbook, the rules governing who was liable for losses from fraud were simple. Customers who had their checkbooks stolen weren't liable for the loss if a thief used them to write hot checks. Similarly, as credit cards took hold, consumers were legally on the hook for just the first \$50 in unauthorized transactions.

But in the digital era—where electronic purchases, payments, and fund transfers can move around the globe at the speed of light—consumers are learning that the old rules don't always apply. Depending on how fraudsters gain access to your account or use your identity, banks may not always absorb the losses. Fraud victims who have wrangled with banks say this is particularly true with unauthorized debit-card transactions or mysterious electronic withdrawals from bank accounts.

Banks still absolve consumers of any losses from the fraudulent use of credit cards—even months later. Most also now waive even that modest \$50 payment. That's not the case for business cards, though. Federal laws that limit user liability apply only to consumers—and most banks make corporate customers assume far more liability for cards issued to their employees. Their reasoning: Employees may not treat a business card with the same care as their own, since it isn't their money.

What's more, while many banks indemnify consumers from fraud involving debit-cards and electronic funds transfers, that's far from universal. Under federal law, banks can hold consumers liable for the first \$50 of losses from cases reported within two days, and up to \$500 in losses going back 60 days. And consumers who wait more than two months after receiving a statement to report fraud may be out of luck. Banks are under no obligation to reimburse them.

That was the experience of John S. Watson, a NASA engineer in Santa Clara, Calif., who discovered in early 2003 that \$7,600 had been transferred the previous fall from his Bank of America account to an Internet-based payment service. BofA

refused to reimburse Watson, saying his claim was outside the 60-day window. So Watson took the bank and the payment service to small-claims court, where a judge ordered both to make him whole. "I had always thought that 'money in the bank' meant your money was safe," Watson now says. BofA declined comment.

While many banks say they reimburse customers for any unauthorized transfers or withdrawals from their checking accounts, that isn't always the case—particularly for businesses. Consider Joe Lopez, who with his wife owns a computer-parts distributorship in Miami. Last April,



SAFE? Banks still cover credit-card losses

Lopez says he discovered a mysterious \$90,348 wire transfer from his Bank of America account to a bank in Latvia from earlier that morning. Lopez immediately notified BofA, which in turn alerted the U.S. Secret Service. When the feds examined Lopez' PC, they discovered it had been infected with a Trojan virus called CoreFlood that helped hackers get his password.

Lopez says when he asked BofA for help, the bank refused—arguing that Lopez was at fault for not using antivirus software robust enough to detect the Trojan. In February, Lopez sued the bank. "I'm not afraid to go up against BofA," he says. For its part, a BofA spokeswoman says, "[we intend] to vigorously defend ourselves." Lopez' experience is a cautionary tale about the importance of antivirus software. And it also serves as a reminder that in cyberspace, it's every man for himself.

—By Dean Foust in Atlanta



COMMENTARY

BY JOHN CAREY

Energizing Energy

The U.S. urgently needs to tap new sources—and conserve old ones

GASOLINE PRICES have climbed above \$2 per gallon, crude is hitting record highs—reaching \$56 a barrel on Mar. 16—and OPEC is pumping more to keep America's oil pain from increasing even more. So it's small wonder that in Washington, panicky pols are suddenly talking the talk on energy policy.

Forget red-state and blue-state America. Now many lawmakers see the energy crunch in shades of green. Indeed, who could possibly be against less-polluting school buses, a more reliable electricity grid, and incentives for solar and wind power—all packaged alongside traditional GOP ideas for increasing oil and gas output? All these items and more are in a massive energy bill that the House of Representatives is expected to take up again in April. Even the White House, which once dismissed conservation as little more than “a sign of personal virtue,” is

now getting in on the act. In a mid-March speech, President George W. Bush said that America needed a strategy that “promote conservation” as well as diversifying and updating the country's energy sources. Of course, that too remains high on the Administration's agenda: On Mar. 16 the Senate vote open up the Arctic National Wildlife Refuge (ANWR) to drilling, though the battle is far from over.

Does this mean Washington is getting serious about a plan? Not really. First, the chances Congress will pass a broad energy bill this year are uncertain. Despite efforts by Senate Energy and Natural Resources Committee Chairman Pete V. Domenici (R-N.M.) to avoid last year's rancor by reaching out to Democrats, the measure could founder on a host of issues: liability protection for makers of the fuel additive MTBE, for instance, lack of money now that the White House has admonished Congress to spend just a fraction of what advocates say is needed.

Even if a measure does pass, it won't do much to impose a national energy regime on a fuel-guzzling nation. “I don't want to say there's nothing in it, but there's not a lot that really makes a difference,” says Obie O'Brien, director of government affairs at Apache Corp., a Houston oil and gas producer. Sure, it's a great idea to provide incentives for everything from renew-



to natural gas supplies, but “the bill does not make an attempt to solve the long-term issues everyone is concerned about: energy security, climate change, and creating technologies,” says one key Hill staffer.

Indeed, in many ways, America is better off without current Washington’s meddling, because rising prices are both a problem and a path to a solution. “The U.S. has not had an integrated energy policy—and that’s probably a good thing,” says David G. Victor, director of Stanford University’s Program on Energy & Sustainable Development. The market works pretty darn well in balancing supply and demand in line. The U.S. economy is large enough to be dragging off today’s \$50-plus-a-barrel oil, thanks to big efficiency gains prompted by past shocks. High prices are stimulating not just traditional oil and gas but newer sources, such as Canadian tar sands. “The industry can expand supply much more dramatically than people think through price,” says Howard H. Newman, vice-chairman of private equity investor Burg Pincus, which has made big development bets everywhere from Rocky Mountain gas to West African oil. That’s why experts expect prices to go much higher.

But don’t expect the market to solve every problem. In electricity, the invisible hand is hampered by a welter of confusing regulations. Meanwhile, the price of oil would be far higher if it reflected the military and national security tab for ensuring the flow of oil. “It’s sheer lunacy” that America is paying billions of dollars for “imported oil from those who wish to do us harm,” says Frank J. Gaffney Jr., president of the Center for Security Policy, a conservative think tank. Plus, oil, gas, and coal prices don’t include the future costs of climate change. Today, the main driving force for a national energy policy is the high price of oil, says Joseph Romm, a former Energy Dept. official. “But in the long term, it will be global warming.”

That’s why the U.S. needs an energy plan—one that goes beyond the compromises and pork-trading that Congress will renege on in Energy Bill, Act III. Here’s what the nation should do:

Improve the Grid

MEMBER THE AUGUST, 2003, blackout? The transmission system has been improved since then, reducing chances of another

outage. But procedures that make the system more reliable are still voluntary. At the least, Congress must make standards mandatory.

Beyond that, the U.S. needs to invest far more in infrastructure. A roadmap from the Electric Power Research Institute describes the path to a “smart,” digitally controlled grid that would boost reliability and efficiency. It would save tens of billions of dollars a year and eliminate the need for dozens of power plants. It would also make it far easier to hook the grid up to small-scale solar, wind, and other alternative sources of power. The government needs to help fund such a network or offer utilities the incentives to make the investments.

CALIFORNIA DRILLING
High gas prices are making more fields viable

» Diversify Supplies

THE U.S. URGENTLY NEEDS to increase the number of suppliers of oil and gas—as well as the availability of alternative sources of energy—to lessen the chances that any given war, coup, or other disruption will cause a spike in prices. Already, exploration and drilling are moving to new regions around the world, from the Caspian Sea to West Africa. Considering new technology and a good safety record for drilling in the U.S., Washington should open up more of the continental shelf and other areas to drilling, as well as exploring the ANWR to find out what’s there.

We’d get a higher payoff, however, by nurturing nonfossil fuel alternatives, including nuclear power. Congress passed tax credits for wind, solar, biomass, and other sources last year, but the breaks expire at the end of 2005. They need to be renewed for 5 to 10 years to provide the certainty that business needs. Moreover, 19 states have moved far ahead of Uncle Sam by requiring that a certain percentage of electricity be generated from renewable sources. The Feds—even the regulation-phobic Bush White House—would be wise to follow suit.

» Boost Energy Efficiency

AS THE PRESIDENT SAYS: “If you want to become less dependent on foreign sources of energy, we’ve got to be better conservers of energy.” If the industrial world curbed its thirst,

it would gain leverage over OPEC and other producers, who need dollars as much as we need their oil. Increased efficiency also cuts pollution, saves money, and slows climate change.

Bush hasn't backed up his words with real action, however. Neither the White House nor Congress is seriously trying to tackle the 800-pound gorilla of oil consumption—cars and trucks. The transportation sector burns more than 60% of the nearly 21 million barrels of oil per day used in the U.S. At 20 miles per gallon, “our national fuel economy is worse than it was 15 years ago. That ought to be unacceptable,” says Representative Sherwood L. Boehlert (R-N.Y.). And in contrast to the situation during the 1970s’ energy crisis, “we know what the solutions are,” says Amy Myers Jaffe, a Rice University energy expert. “We don’t have to make a better car. We already have a better car.” By boosting average consumption to 40 mpg—which is doable—America would eventually use 6 million fewer barrels of oil every day.

Again, the states are ahead of the feds. California has proposed 30% cuts in auto carbon dioxide by 2015. A market-based approach would combine higher fuel-economy standards with stiffer taxes for purchasing cars with lower gas consumption, and tax credits for vehicles that consume less. If Congress had the political moxie, higher gas taxes would also help steer people to more frugal cars. One example: the takeoff of high-mileage diesel cars in Europe.

»Take Global Warming Seriously

IF CLIMATES CHANGE, potentially bringing flooding and agricultural disruptions, then today’s concern over oil prices or imports will seem trivial. The next generation will blame us for arguing instead of making big cuts in fossil fuel use to minimize the chances of a global catastrophe. William K. Reilly, Environmental Protection Agency administrator under Bush’s father, recently co-chaired the bipartisan National Commission on Energy Policy, which called for mandatory curbs on carbon. “What I learned from the experience is that it’s a mistake to put our chips just on clean coal or on renewables, or nuclear power, or other sources,” he says. To make a meaningful difference, “it will require every one of them.”



SHALE OIL Colorado



GAS REFINERY Brazil



WIND TURBINES Oregon

Another Way?

As energy prices rise, alternative sources are becoming profitable:

OIL \$56 per barrel on Mar. 16

At \$25-30:

- Oil mined from tar sands

At \$35-40:

- Liquefied coal
- Processing sugar to alcohol

At \$40 and up:

- Oil from shale

NATURAL GAS \$7.13 per million BTUs on Mar 16

At \$2.50 to \$4.00:

- Imports of liquefied gas

At \$3.50 to \$4.00:

- New production off Gulf Coast

At \$4.00 and up:

- Production from western Canada

ELECTRICITY \$50 per megawatt-hour (current average wholesale price)

At \$33*:

- New nuclear plants

At \$41*:

- Wind power

At \$112*:

- Solar power

*Estimated levelized cost in 2010 without subsidies

Data: Center for Energy & Climate Solutions, Cambridge Energy Research Associates, Electric Power Research Institute, Platts

Much of the industrialized world has come to the same conclusion by ratifying the Kyoto Protocol and setting ambitious goals for slashing emissions. As a result, the U.S. is falling behind in efficiency gains. Japan, for instance, is the leader in solar and hybrid cars, while Europe leads in wind

at start, the U.S. needs to pass the modest mandatory limits on carbon pollution by Senators John McCain (R-Ariz.) and Joseph Lieberman (D-Conn.) and those embraced by the commission.

There’s no guarantee these measures will work. Energy policy is notoriously complex and tends to have unintended consequences. Dramatic increases in energy efficiency, for instance, and the resulting drop in demand will send prices plunging, taking away incentives for conservation. If companies have hesitated from investing in oil exploration, or in efficiency measures, because prices have been so low until recently—and wouldn’t be surprised by another dip. “Oil is a commodity,” says Exxon Corp. CEO Lee Raymond, adding that commodity prices rarely stay high for long.

What’s most important for successful energy policy is certainty. Goldilocks price of energy—not too high, not too low. If prices stayed relatively high, though enough to sap the economy, and slowly climb

they would offer a powerful incentive to invest continually in both efficiency gains and new sources. How could we provide that certainty? If Washington had courage, it could simply slap a slowly rising tax on emissions of carbon. In one move, that would make fossil fuels gradually more expensive, smoothing out price swings and spurring the development and adoption of everything from efficient cars to green power. It could even be good for the economy, if the revenues returned to companies in the form of reduced payroll taxes. research and development funds for new technologies. Of course, that idea is politically untenable in today’s Washington. So instead, expect Congress and the White House to endlessly over sideshow issues like farmer-friendly ethanol drilling in the ANWR while another opportunity to make a difference is lost. We can do better. ■

—With Chris Palmeri in Los Angeles and Wendy Zellner in London



LAKE CHARLES, LA. The Gulf Coast is more receptive to LNG terminals than other areas

ENERGY

Ports in the Storm for Liquefied Natural Gas

From Maine to California, developers of liquefied natural gas (LNG) terminals are facing protests at every turn. With opponents of this critical piece of the nation's gas supply painting horrific scenarios of terrorist attacks and raging infernos, it's easy to understand why. The Northeast has "gone way past 'NIMBY' [not in my backyard]," says Wallace P. Parker Jr., president of energy delivery at KeySpan Corp., which serves 2.6 million customers in New York, Massachusetts, and New Hampshire. In fact, he says, it has gone "NANANA"—Build Absolutely Nothing Anywhere Near Anything.

In the face of such opposition, some LNG projects have already been shelved. But despite the battles, the U.S. is likely to get the terminals it needs. That doesn't mean all of the nearly 50 proposed U.S. terminals will be built. But that's O.K. Energy execs figure four to six new terminals will be enough for years to come—and six new projects have already won federal approval. In addition, three of the nation's four existing import facilities are being expanded. "It's my firm belief that terminals will be built in a timely manner," says Mark G. Papa, chief executive of Houston-based natural gas producer EOG Resources Inc.

There's little question that the U.S. will need to depend more heavily on imported LNG. Despite increased drilling with improved technology, U.S. gas producers will be lucky to hold supplies flat over the next five years, says Papa. And Canada won't fare much better. Yet demand is expected to grow, especially from gas-fired power plants. So while LNG fills only about 3% of the nation's gas needs now, it's expected to grow to 14% by 2010 and nearly 25% by 2020, according to consultancy Pace Global Energy Services.

Rising LNG imports could help put a lid on gas prices, which averaged more than \$6 per million BTUs over the past year, vs. \$2 in the 1990s. "LNG will bring about a price stabilization. You won't see the volatility that we're seeing today," predicts Sempra Energy CEO Stephen L. Baum. Sempra is building an LNG terminal in Mexico to serve both the Mexican and Southwestern U.S. markets.

It's not clear yet whether any terminals will be built in

California or the Northeast, where opposition has been the fiercest and where future gas supplies are expected to be the tightest. Opponents point to such devastating accidents as an explosion last year at an Algerian liquefaction plant that killed more than two dozen people. The Conservation Law Foundation, an environmental group, says none of the LNG proposals for New England provides for an adequate one-mile safety zone around the tankers that will serve the terminals.

Industry executives point to the 43 LNG storage tanks already operating safely in New England and say that LNG tankers have traveled more than 80 million miles without incident. But those statistics don't

take into account "the risk of intentional attack," says CLF President Philip Warburg. "Circumstances fundamentally changed with September 11."

It's no coincidence that the new LNG terminals that have been approved will all be in the Gulf of Mexico or on its coast. Residents there are far more accustomed to energy infrastructure than folks elsewhere and welcome the possibility of new jobs. Executives at Cheniere Energy Inc. received a standing ovation in December from a couple of hundred Corpus Christi (Tex.) residents after a presentation about their project there.

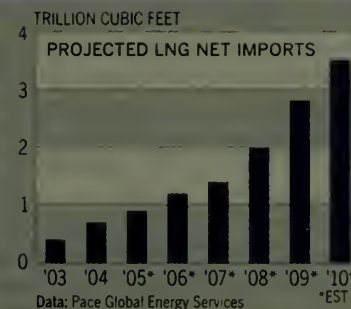
So why not serve the Northeast and California from remote terminals? It's possible. But Robert Ineson, a director of Cambridge Energy Research Associates warns that would require hundreds of miles of new pipelines, creating its own permitting battles and transportation costs.

Offshore terminals might be another part of the solution. Excelerate Energy LLC, for instance, is ready to start operating the world's first offshore LNG receiving terminal in the Gulf of Mexico. The company is proposing a similar vessel off the Massachusetts coast. Shell is planning a

floating terminal to be moored in Long Island Sound. Still, as Excelerate President Kathleen Eisbrenner notes, "There are no LNG terminals that are easy to permit, even offshore." It looks like the protests won't fade away anytime soon.

—By Wendy Zellner in Dallas, with Brian Hindo in New York

FILLING THE GAP?





TRADE

THE DEFICIT: THE SKY MAY NOT BE FALLING

Some Fed officials think current-account woes stem from a world savings glut

WHEN THE COMMERCE Dept. announced on Mar. 16 that the current-account deficit ballooned to a record \$665.9 billion last year, the dollar took a knock, falling lower against the euro and the yen. Behind the currency's swoon: concern that the U.S. has become so dependent on foreign money to fund its current-account and budget deficits that sooner or later the dollar must crash.

Not so, say a number of top Federal Reserve officials. In a new analysis that turns conventional wisdom on its head, they argue that the swelling current account deficit is not the result of U.S. profligacy on the part of a tax-cutting President Bush and import-happy U.S. consumers. Rather, the gap—which consists mainly of the trade deficit but also includes interest, dividends, and other financial payments—stems largely from what Fed Governor Ben S. Bernanke calls a “global saving glut.” The excess savings have

their origins in both slow-growing industrial economies such as Japan and Germany and fast-growing emerging markets like China and India.

According to this theory, the glut is holding down interest rates in the U.S., freeing the federal government to run big budget deficits and allowing debt-laden consumers to spend more. If Bernanke is right, fears that foreign funds will dry up and lead to the collapse of the dollar are significantly exaggerated. What's more likely is a continuation of the dollar's gradual fall; over the past three years, the greenback has shed 15% against the currencies of America's major trading partners.

Not surprisingly, Bernanke and his peers' take on trade is not one that has won much support in foreign capitals. Instead, many European and Asian poli-

SLOW COUNT
Asians' appetite for dollars has eased the slide

cymakers place blame for America's bulging current-account deficit squarely on the U.S. and

debt-driven economy.

Still, the “don't worry, be happy” approach to the trade deficit got a boost Mar. 15, when the Treasury Dept. announced that foreign financiers bought \$91.5 billion worth of U.S. bonds, stocks, and other financial assets in January, up sharply from \$60.7 billion in December and was the second-highest ever. More important, net foreign inflows dwarfed the \$58.3 billion deficit that the U.S. racked up during January. And it was private investors, including hedge funds—not foreign banks—who did the bulk of the buying. Many of them piled into the U.S. market to take advantage of its stock-price rally.

THE RETIREE EFFECT

THE STRONGEST EVIDENCE for a global savings surplus comes from rapidly aging societies of Japan and Europe. Workers there need to build up savings for retirement but face a dearth of investment opportunities in their slow-growing economies. So they're investing money abroad, including in the U.S. That, St. Louis Fed Bank President William Poole said in a speech on March 15, makes perfect sense, given the breakneck growth of U.S. financial markets and the dynamism of the U.S. economy. After all, while the U.S. is also graying, its retiree population isn't growing nearly as quickly as Japan's or industrial Europe's. By 2040, the U.S. will have 34 retirees for every 100 working-age people, vs. 21 now, according to U.N. projections. Japan will have about 78 for every 100 20-to-64-

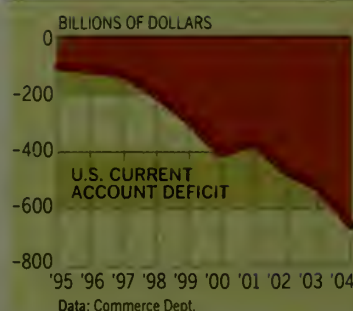
olds, and Europe,

When Japanese and Europeans start retiring in droves, they'll draw down their savings and spend more money on goods and services, some of which will come from the U.S. “America can be made the beneficiary of the current-account surpluses of these countries as well as the current-account deficit,”

the U.S. will be reversed in the future, Poole says.

But it's not only Europe and Japan that are piling up their savings. Many emerging-market countries are, too.

IN THE HOLE





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though China, for instance, is investing billions of dollars in new factories, it's still not spending nearly as much as it is saving. The balance is invested abroad, much of it in U.S. Treasury securities. Chinese holdings of Treasuries rose to \$194.5 billion in January from \$156.2 billion a year earlier.

THE WAR CHEST FACTOR

CHINA IS NOT alone. South Korea, Taiwan, Thailand, and Brazil all increased their holdings of Treasuries over the past year. Stung by the financial market crises of the mid-to-late '90s, they have opted to build up their foreign currency war chests to insulate themselves against the vagaries of international capital market flows. Some, such as China, are also seeking to ensure economic stability and boost their exports by linking their currencies to the dollar.

Aging societies look to the U.S. to invest nest eggs

So are Bernanke & Co. right about the reasons the current account went from balance in 1991 to 5.7% of gross domestic product last year? The argument seems to hold up for the late 1990s, when foreign money poured into the U.S. stock market and the dollar soared. Even after the bubble burst, foreign funds kept coming. Big purchases of Treasuries and mortgage-backed securities helped keep long-term interest rates low, fueling a refinancing boom that spurred a consumer binge on domestic and imported goods.

Of course, foreigners' push to invest in the U.S. isn't the only reason for the surges in the trade and current-account deficits since 2000. Big tax cuts—and the budget deficits they bought—also powered imports. What's more, the dollar's fall over the past three years, and especially its precipitous 40% drop vs. the euro, suggests that financing the trade deficit has not been trouble-free.

The Fed's optimists acknowledge these warnings—but still believe that the foreign savings glut will dominate. If they're right, there's no big rush in cutting the current-account deficit. The deficit will someday fall—not with a bang of a dollar crash but slowly, as the rest of the world gathers the rewards of the savings it invested in America. ■

—By Rich Miller in Washington

HOLLYWOOD

HELLO DREAMWORKS, GOODBYE PIXAR?

With Michael Eisner out of the picture, Disney has more options

THE 40 WALT DISNEY CORP. production staffers working in a low-slung building in Glendale, Calif. were Michael Eisner's answer to his Pixar Animation Studios problem. Pixar makes hit films like *Finding Nemo* and *The Incredibles* for Disney. And its chairman, Steve Jobs, has been pushing Disney for more lucrative terms when the two sides try to renegotiate a new contract later this year. But just in case that falls through, the Glendale crew is already hard at work on *Toy Story 3*, the sequel to Pixar's 1995 and 1999 blockbusters that Disney intends to make with or without Pixar. Now, with the Mar. 13 board selection of President Robert A. Iger as Disney's next CEO, the story may have an entirely new ending.

Disney board members are urging Iger to put the Pixar situation at the top of his to-do list, says a source close to the board. He may already have an opening for a deal. Jobs, who clearly disliked Eisner, was among the first to send a congratulatory e-mail to Iger.

But Iger has other options. Some studio insiders say he may make a bid for DreamWorks Animation SKG, the studio started by David Geffen, Steven Spielberg, and former Disney studio chief and longtime Eisner foe Jeffrey Katzenberg. DreamWorks produced edgy hits like the two *Shrek* blockbusters and last year's *Shark Tale*.

Despite Katzenberg's courtroom battles with Eisner over his compensation, a

deal with DreamWorks might not be as unlikely as it seems. As president of Disney prior to its 1996 acquisition by Iger, Iger bought a 1% stake in the studio. Iger bought a 1% stake in the studio and ordered the studio to produce shows for the network. When Iger fired TV reporter Willow Bay in 1997, Katzenberg was front and center. "I've always had a good relationship," says a friend of Iger's.

both. The deal could be structured as a stand-alone unit, similar to Disney's arrangement with Miramax, which was negotiated by Katzenberg. But it would face hurdles, including a hefty price tag and DreamWorks' existing distribution deal with NBC Universal. Neither Iger nor DreamWorks would comment.

And even as Iger makes friendly overtures to Iger, he is



CEO-TO-BE IGER
DreamWorks' Katzenberg is a pal

ing elsewhere business that might otherwise have gone to Disney. In April, Pixar negotiated a licensing deal for video games with THQ Inc. and is looking at potential partners for its merchandise. More of a stumbling block, Jobs wanted to cut in half the 12.5% fee that Disney gets for marketing Pixar films. And Iger wants full control of all Pixar films, which are now controlled by Disney.

Still, both sides have a lot to gain from working out a deal. Clearly, Iger's choice is to stay with Pixar, which contributes about 50% of Disney's studio profits, figures Merrill Lynch analyst Jessica Reif Cohen. Iger, who has years of experience repairing egos bruised by abrasive Eisner, will have his hands full with Jobs. But in any tough negotiation, it's always good to have options. ■

By Ronald Grover in Los Angeles



A CRYSTAL BALL MELDED WITH A TACHOMETER.

[Is how one CFO described financial forecasting & reporting from Hyperion.]

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EDITED BY MONICA GAGNIER

HEADLINER

KEVIN MARTIN



KEEPING THE VOLUME LOW

The Bush Administration, weary of controversy at the Federal Communications Commission, on Mar. 16 tapped **Kevin Martin**, a discreet deregulator, for the top job. Martin, 38, is widely viewed as a consensus builder and a savvy operator than outgoing Chairman Michael Powell, who ruffled feathers with his autocratic style. A commissioner for four years, Martin has strong ties to Team Bush, having worked on the President's 2000 campaign.

While Martin was at odds with Powell over rules that require local phone companies to lease their networks to upstart rivals, the two were mostly on the same policy wavelength. Martin is expected to continue the FCC's push to deregulate big media and broadband and to pursue its crusade against indecency over the airwaves. But big challenges loom that will test Martin's political skills. Chief among them: renegotiating the complex system that subsidizes local phone service and getting broadcasters to make the digital transition for good.

—Amy Borrus

MEDIA: GOING TO PIECES

After a decade of consolidation, media giants with stagnant stock prices are looking to break apart their companies. **Viacom** confirmed on Mar. 16 that it was considering splitting the company up. Sources say one piece could include **CBS** and **Infinity Broadcasting**, while the other would consist of red-hot **MTV**, other cable networks, and the **Paramount** studio. Viacom's stock rose \$2.70 on the news, to \$37. A day earlier, John Malone's **Liberty Media** unveiled plans to spin off its 50% stake in cable network **Discovery Communications**. Investors could benefit, but the biggest winners will surely be fee-hungry investment bankers, the same ones who put these giants together.

GRABBING TIVO'S REMOTE



Digital videorecording pioneer **TiVo** on Mar. 15 struck a deal to offer its TV recording software to customers of **Comcast** nationwide by late 2006. With the nation's largest cable operator giving the money-losing TiVo a new lease on life, the deal could lead to similar licensing pacts from other cable providers and consumer-electronics companies. TiVo has been

losing ground to cheaper digital recording offerings from cable and satellite providers. As part of the deal, the two will share revenue from interactive advertising in a model that could be emulated by others.

DUSTUP IN CAMBRIDGE

The firestorm over **Harvard University** President Lawrence Summers' management style shows no sign of abating. On Mar. 15, Harvard's faculty of arts and sciences voted 218 to 185 to express a lack of confidence in Summers. While humiliating, the rebuke has no real effect. The Harvard Corp., which alone can fire the president, still backs Summers; soon after the vote, Corporation Senior Fellow James Houghton (also the chairman of **Corning**) reaffirmed his support. Still, the bad blood may hurt Summers' efforts to overhaul undergrad education.

INTO THE FIRE AT AIG

Martin Sullivan may be only the third CEO in the history of **American International Group**, but he'll have no time to savor his promotion. Sullivan, 50, replaced Maurice "Hank" Greenberg on Mar. 14 as regulators are again scrutinizing the insurance giant, which paid out \$126 million in fines last year. The allegations this time: that Greenberg, 79, initiated a deal with General Re that artificially boosted AIG's reserves by \$500 million. Greenberg denies wrongdoing. The task of cleaning up the mess lies with Sullivan.

But don't weep for Greenberg. Besides his \$2.7

billion in stock and any pension or severance benefits, he has got a buyout coming. Since 1993, he has deferred at least \$72 million in bonuses from Starr International, a private equity company controlled by AIG executives. Earlier contributions starting in 1975 were not available. Add those in, and figure investment returns, and Greenberg's takeaway is likely to be much higher.

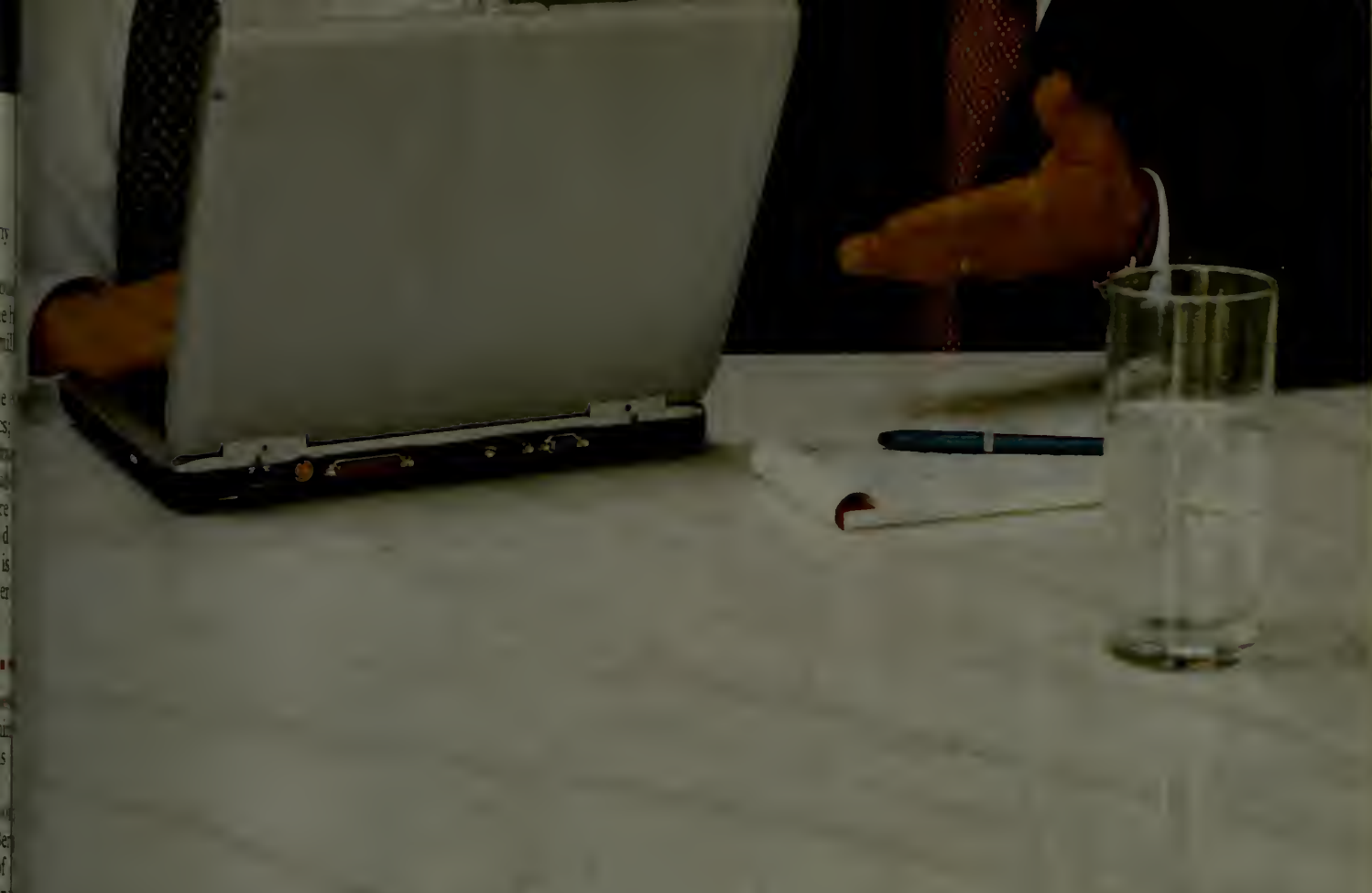
ET CETERA...

► **Eastman Kodak** will release its 2003 and 2004 earnings. ► **Fidelity Investments** is starting a company to manage institutional money. ► **Ex-WorldCom** CEO Bernie Ebbers was convicted of criminal fraud. He'll appeal.

CLOSING BELL

Shares of **Research in Motion** rose 18% on Mar. 16, to \$78.96, after the Waterloo (Ont.) company settled a patent dispute, ending doubt about its right to sell BlackBerrys in the U.S. Under the deal, RIM will pay holding company NTP \$45 million and gain licensing rights.





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MEXICO

THE SAGE OF MEXICO CITY

Carlos Slim has a knack for good deals—including a big stake in MCI

MOST MEXICANS come into contact with billionaire Carlos Slim Helú many times in the course of a normal day. Their bedsheets may come from one of his Sears stores. Their morning pastry may be baked in one of his Globo bakeries, and they may meet friends for lunch at Sanborns, the ubiquitous restaurants linked to his mini department stores. There's a 9-in-10 chance that their mobile phone service is provided by Slim's Telcel. At the office, their telephones and high-speed Internet probably carry his Telmex brand. If they're distracted while driving home from work, the fender-bender may be covered by his Inbursa insurance company. The nightly news most Mexicans watch is on Televisa, whose second-largest shareholder is—guess who?

BOTTOM FISHER

NO WONDER SOME have dubbed Slim the Warren E. Buffett of Mexico. Like the legendary Sage of Omaha, the 65-year-old Mexican mogul has a knack for spotting undervalued assets, especially favoring those that throw off lots of cash that can be used to buy more companies. "Slim is simply a very good operator who's quite cost-conscious and is careful not to overspend on acquisitions," says Damian Fraser, director of equity research at UBS Warburg in Mexico City. "In that sense, he's very much like Buffett."

The bottom fishing has worked for Slim. The latest *Forbes's* list of billionaires ranks this son of a modest Lebanese merchant as the fourth-richest man on earth, with an estimated net worth of \$23.8 bil-

lion. That's a 40% jump from the previous year. The effervescent Mexican stock market gets a chunk of the credit. The *bolso* was up 47% in 2004, buoyed in part by the strong performance of Slim's companies, which account for nearly half the total capitalization.

Now the Mexican businessman is making his presence felt in the U.S. As the single biggest investor in MCI Inc., he's pressuring the board to hold out for richer buyout offers from Qwest Communications International Inc. and Verizon Communications for the telecom company in which his family and the businesses they control have a 13.7% stake.

The MCI gambit is classic Slim. When the troubled telecom filed for Chapter 11 in 2002, he spent \$300 million to buy its defaulted bonds, paying as little as 13.5¢ on the dollar. He converted the bonds into shares when the company emerged from bankruptcy last year, and his holdings are now worth \$1 billion. Slim says his investment in MCI is purely financial. "If we were interested in operating MCI, we would be buying [control]. We wouldn't be sitting around waiting like masochists," Slim told *BusinessWeek*. "When we decide to do something, we do it quickly."

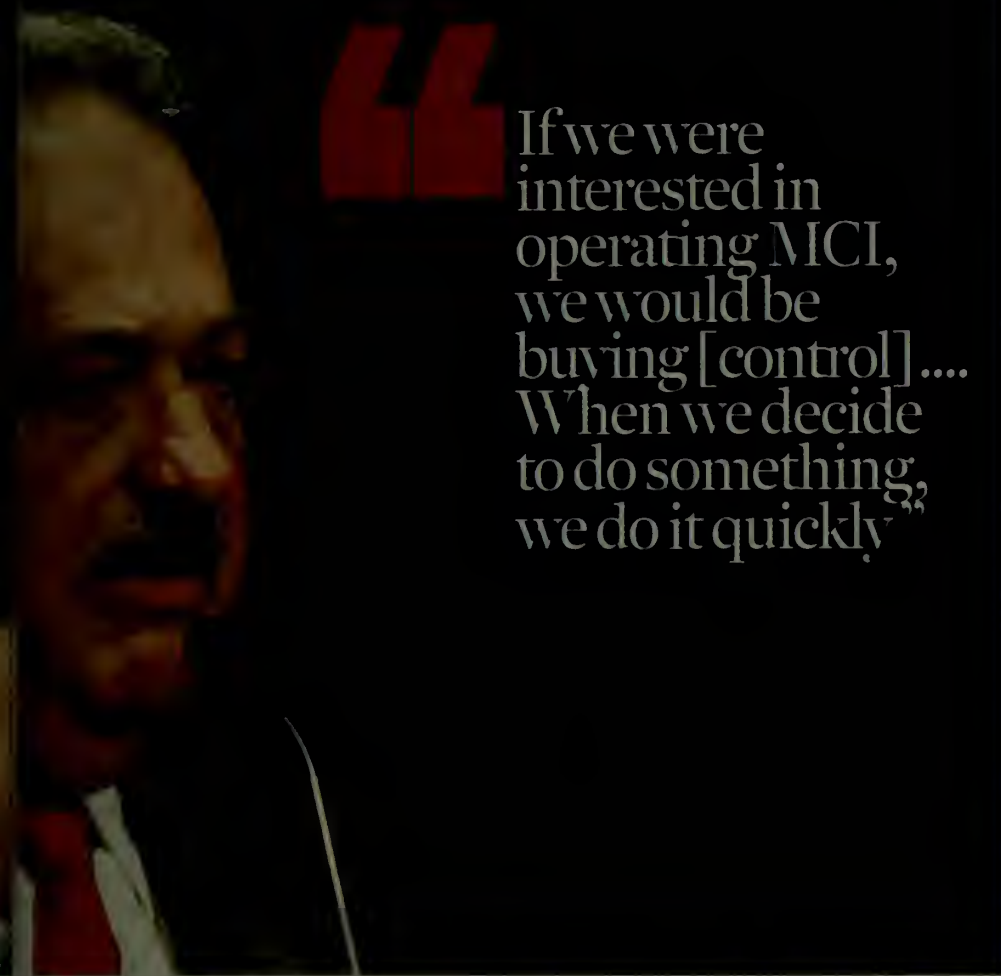
That doesn't mean Slim lacks an opinion on how MCI should be run. When MCI executives turned down an \$8 billion bid from Qwest and started mulling over a lower, \$6.75 billion offer from Verizon, Slim made his opposition known. "We feel that the Verizon offer is very low, and that the Qwest offer is [only] a little better," says Arturo Elias, Slim's son-in-law, who acts as the family's official spokesman. "What we have to do is seek the best for our shareholders." Meaning: Slim and

Mundo Slim

Mexican billionaire Carlos Slim has built an empire spanning telecom, retail, manufacturing and financial services. He has the cash thrown off by his businesses to make financial investments in a variety of U.S. companies. Figuring out Slim's holdings is fiendishly difficult since he uses a variety of vehicles to make his purchases. Even an approximate list shows how shrewd a player he is.

his six children, as well as several controlled companies that own shares, including telecom giant Telcel.

What is Slim's secret? A civil engineer by training and a math whiz who can digest complex financial statements effortlessly, Slim is fast at determining when an asset is properly valued. Before investing in a company, he familiarizes himself thoroughly with the outlook for that



If we were interested in operating MCI, we would be buying [control].... When we decide to do something, we do it quickly.”

Slim paid \$1.76 billion for control of telephone monopoly when it was in 1990. Fifteen years on, Telmex is still a dominant player, with its shares up 17% in 12 months. Slim's stake is now worth \$1.76 billion.

MOVIL Built up the largest cellular phone company in Latin America, with operations in seven countries plus the U.S. Stock has risen 56% in 12 months. His stake is valued at \$1.76 billion.

ALTRIA GROUP Accumulated a 12% stake in the struggling retailer before a complete takeover in 2000. The company is now traded in the U.S., despite its struggles, is still posting

MCI Slim's masterstroke. He swapped some \$1 billion in MCI bonds purchased after the company filed for bankruptcy in mid-2002 for shares now worth around \$1 billion. Owns 13.7% of the company. In any sale of MCI, Slim will be influential.

SAKS Slim's 11.6% stake in the upmarket retailer is now valued at \$251 million.

GLOBAL CROSSING His 19.9% stake in the Internet-based telecom carrier, which emerged from bankruptcy in 2003, is worth \$68.8 million at current prices.



ALTRIA GROUP Slim's Citagam company manufactures cigarettes for Philip Morris. Slim currently holds 4.1 million Altria shares, valued at \$267 million, and sits on the board.

Data: Bloomberg Financial Markets, U.S. Securities & Exchange Commission

and the prospects for competition. But in addition to doing the usual short-term number-crunching that Wall Street analysts do, Slim takes a long-term business view of a company's intrinsic value—everything from its human capital to its real-estate holdings—such as Altria Inc.'s more than 300 department stores and its flagship building on New York's Fifth Avenue. (Slim has built up a

nearly 12% stake in Saks.) If the company is undervalued, he's interested. Slim's other big holdings include tobacco giant Altria Group, fiber network Global Crossing, and SBC Communications, his long-time investment partner in Telmex.

Slim Inc. is often viewed as a one-man show—one reason his companies' shares trembled six years ago when he suffered complications following heart surgery. But

there's more to his empire than Slim alone. “He [has] a good team that can make companies profitable in a very short time frame,” says Celso Garrido, an economics professor at the Autonomous Metropolitan University in Mexico City who uses Slim's empire-building record as a case study in his classes. The Mexican mogul is advised by a small cadre of trusted executives numbering probably no more than a half-dozen—including his three sons, all of them in their 30s, and the long-time CEO of Telmex, Jaime Chico Pardo, in addition to Eduardo Valdés, an experienced investment banker at his Inbursa financial group. “Our way of working isn't a hierarchical, pyramid style of leadership,” says son Marco Antonio Slim Domit, 36, chairman of Inbursa.

As Slim's fortune and influence have grown, investors worldwide are starting to pay more attention to the man who until the 1990s was mostly known as a successful stock broker who founded a conglomerate that made tires, cigarettes, and copper cable and also operated mines and retail stores. His \$1.76 billion purchase of Telmex, Mexico's national telecom monopoly, in 1990 catapulted him into unfamiliar territory. But “*el ingeniero*” proved a fast learner. Slim carried out an impressive turnaround, more than tripling the number of land lines, building a nationwide fiber-optic grid, and vastly improving service.

At the same time, critics charge that Slim and his cadre of lawyers have taken advantage of Mexico's pliant regulators to frustrate attempts by the likes of MCI and AT&T to make inroads into the market. Telmex currently boasts a hefty 70% share of all long-distance traffic, and its operating margins—31.4% in 2004—are nearly double those of industry giants such as SBC or France Telecom. “Mr. Slim has enormous influence in this country, and

apparently he uses it,” says Garrido.

Nonetheless, Slim has demonstrated that he can succeed outside his home market. His América Móvil has become the largest cellular-phone operator across Latin America, with more than 61 million subscribers, thanks to a string of acquisitions. The company's stock soared 88% last year. Telmex is also expanding overseas, spending \$360 million last year to

(TOP TO BOTTOM) PHOTOGRAPHS BY ARNULFO FRANCO/AP/WIDE WORLD; CHARLES DHARAPAK/AP/WIDE WORLD

purchase MCI's controlling interest in Brazilian long-distance operator Embratel Participações.

Slim has built up his telecom empire by snapping up the assets of world-class players that poured billions into Latin America in the 1990s only to beat a retreat when the telecom boom cooled and the economies of Brazil and Argentina tanked. In 2003, for example, Telmex scored a coup when it bought out the assets of AT&T Latin America for \$207 million, including a fiber-optic network that cost \$1 billion to build.

Not everything the Mexican touches turns to gold, though. In 2000, not long before the U.S. tech bubble burst, he bought control of troubled computer retailer CompUSA and assigned his eldest son, Carlos Slim Domit, 38, who before becoming chairman of family conglomerate Grupo Carso managed its retail holdings, to turn it around. But the hypercompetitive U.S. retail market proved a challenge: CompUSA posted a \$4.5 million loss last year, despite an ongoing restructuring. "If things don't change for the worse in the

U.S., CompUSA should show better results this year and the next," says Slim. An apparent plan to merge CompUSA with Circuit City Stores Inc. was shelved when the rival chain's shareholders rebuffed the Slims' offer of \$8 a share—an 18% premium over traded value, but well below Circuit City's \$11 per share book value. "Slim would never engage in a hostile takeover," says one longtime acquaintance.

With the exception of CompUSA, Slim has stuck to purely financial investments in the U.S., confounding analysts who were certain he would try to take control of MCI—or of Global Crossing or Saks. So, even while U.S. observers wonder if Slim has greater plans for MCI, those who've followed his strategy in Mexico and Latin America see the play for what it is: an investment aimed at wringing the best value out of shares that have already more than tripled his initial investment. Not bad for a three-year bet. ■

—By Geri Smith in Mexico City, with Brian Grow in Atlanta and John Cady in New York

The fierce retail PC market proved a challenge for Slim

JAPAN

SONY'S DILEMMA

Can it afford to spin off its insurance unit?

SONY IS A NAME THAT'S almost interchangeable with high-tech gizmos—from its Handycam video recorders and Vaio laptops to the PlayStation 2 game machines found in nearly every family room. But few know that what's producing much of the profit at the company these days doesn't run on batteries. One of Sony Corp.'s chief cash generators is its thriving business in Japan selling insurance policies and on-line banking services (Sony also markets a credit card in the U.S. issued by JPMorgan Chase & Co.) Life and auto insurance, plus Internet savings accounts, grouped under Sony Financial Holdings will earn an estimated \$509 million in operating profits this year, figures Merrill Lynch & Co. That's almost as much as motion pictures will earn and contrasts with a projected \$288 million loss in consumer electronics.

'LOVE AND TRUST'

BUT INCOMING SONY CEO and Chairman Howard Stringer faces huge pressure from investors to improve profitability and spin off businesses that don't fit into the core strategy of fusing gadgets with films, music, and game software. Under Stringer, businesses without clear cross-selling potential may have a hard time justifying their place in the Sony pantheon, no matter how much cash they throw off.

Another issue: Despite its contribution to earnings, Sony Financial's \$33 billion asset base has pulled down the company's overall return on assets to an estimated 1.7% this fiscal year. "I just don't see a lot of synergies," says



TOKYO
Sony
financial
unit
cash

Naoko Nemoto, insurance analyst at Standard & Poor's in Tokyo.

Sony already plans to take the financial unit public in 2006, but retain a controlling stake. Sony Financial is worth \$7.1 billion, based on a multiple of times operating cash flow, estimates Merrill analyst Hitoshi Kuriyama. It could help bankroll the next generation of must-have gadgets.

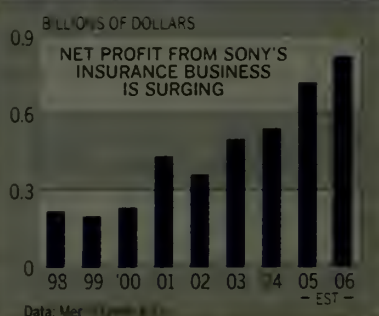
This Sony sideline dates back to 1978. The idea was that the Japanese would trust the company that builds their television sets to sell them high-quality financial services. Today Sony Life Insurance sells accident, medical, and life insurance policies under the tagline "Love and Trust." Last year it saw a 5% rise in premium income when the rest of the Japanese insurance industry contracted. But Nippon Life and Sumitomo Life, which have been burdened with bad debt, are covering. As competition heats up, Sony may not have the wherewithal to compete with them and well-capitalized foreigner

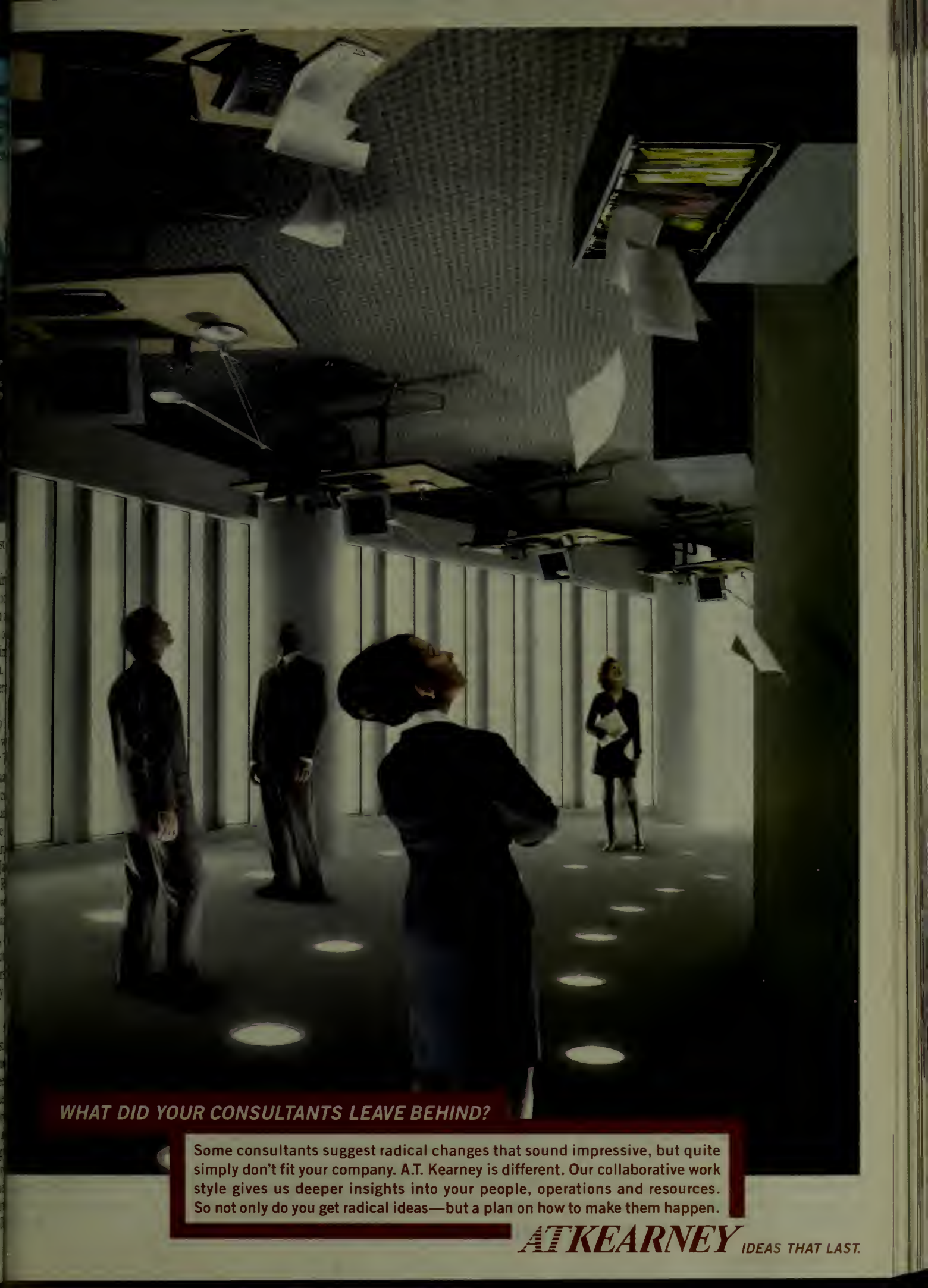
American Family Assurance Co.

Sony tried to exit its insurance business last year, but backed off after employees rebelled at the idea of falling into foreign hands. Now that a foreigner is calling the shots, that may no longer be an issue.

—By Brian Brantley in Tokyo

SONY FOR LIFE





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INDIA

A WHIFF OF TERROR IN BANGALORE

A foiled bomb plot has outsourcing shops rethinking security measures

ON MAR. 5, INDIAN police surrounded a two-room house on the outskirts of New Delhi. Holed up inside were members of Lashkar-e-Toyba, a Pakistani terrorist group active in the mountainous state of Kashmir. Police commandos soon rushed into the house, killing three men. Inside the hideout, they found three AK-56 rifles, hand grenades, 220 pounds of explosives, and detailed plans for an assault on the Indian Military Academy in Dehra Dun, the kind of facility they have typically attacked. But this time around, police found evidence of a different sort of target: technology companies on Mahatma Gandhi Road, Bangalore's main drag.

Four days later, software house Wipro Technologies got a bomb threat at its office on Mahatma Gandhi Road. For two hours, police combed hallways and offices with bomb-sniffing dogs. It turned out to be a hoax, made by a Wipro engineer who claimed to be "testing" security alertness. He was arrested. Then on Mar. 14, another bomb scare forced the evacuation of the headquarters of Infosys Technologies Ltd., though that, too, was a hoax.

SPREADING THE DATA

THE INCIDENTS have caused flutters across India. Indians are accustomed to terrorism in Kashmir, but Bangalore, deep in the south, had long been thought safe. While Bangalore's risk rating is still low, according to security consultant Hill & Associates, an attack could be devastating. The \$22 billion information-technology industry contributes 3.5% of India's gross domestic product. Bangalore is home to nearly 1,500 tech companies and some 200,000 of their employees, and it accounts for 40% of India's IT revenues. "An attack on any of the multinational tech

firms here could close down large parts of the city and get global attention," says Paul Ingram, a Bangalore-based manager for Hill.

After a near-war with Pakistan and the New York attacks of September 11, 2001, many outsourcing companies have already boosted security. They have spread data to various sites worldwide. Bangalore execs say that means an attack on one facility would cause minimal disruption and that engineers could pick up work at other sites almost immediately. Infosys stations armed guards at its gates and has isolated visitor parking lots from buildings to limit the potential damage from a car bomb. Employees at most companies are frisked before entering offices, and Wipro, SAP, and Hewlett-Packard have installed electronic systems for retina scans and fingerprint identification.

But after the incident in New Delhi, tech companies are taking a closer look at security. Wipro's security chief is recommending that his company move out of offices that face busy streets in Bangalore



ON ALERT A scare at Wipro turned out to be a hoax

and Hyderabad, and into farther from main thoroughfares. At the 330-acre Electronics City, a Bangalore office

where 25,000 techies work, companies have asked city officials for a fire station, police checkpoints, and armed patrols. "We need to beef up security," says H. Prasad Rao, president of the Electronics Industries Assn., which represents tens of thousands of companies.

So far, there's no evidence that the threat is hurting business. The outsourcing wave continues unabated, and the industry expects to see 33% growth this year. Furthermore, tech execs are confident the weather a crisis. "If you want to destroy a software company, you need to hit a million zeros and ones," not just office buildings, says Subroto Bagchi, chief operating officer of software house MindTree Corporation.

And many insist Bangalore is as safe as New York, Los Angeles, or London. "No determined group can penetrate anywhere," says S. Banerjee, president of enterprise solutions at Wipro. "But we are on guard." India, maintaining that balance is an essential step in keeping the outsourcing boom on track. ■

—By Josey Puliyyer
ruthel in Bangalore
and Manjeet Kripalani
in New Delhi

Lockdown

Here's how India's outsourcing shops are beefing up security in the face of terrorism:

- Data are constantly transmitted to multiple locations worldwide for backup
- Armed guards patrol facilities and check vehicles entering office parks
- Visitor parking is isolated from offices to guard against car bombs
- Street-front offices are being moved to more isolated locations
- Employees' eyes and fingerprints are scanned for positive identification

Data: BusinessWeek

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CHINA

GOLF, SUSHI—AND CHEAP ENGINEERS

China's Dalian is becoming an outsourcing center for multinationals

STROLL ALONG THE APTLY named Japanese First Street in downtown Dalian, and it's easy to forget you're in northeastern China. With its faux rice-paper lamps and shoji sliding doors, the street could easily pass for Tokyo. There are restaurants with names such as Fuji and Fukuhana, and signs on storefronts are all in Japanese. Kimono-clad women stand outside sushi bars and karaoke joints, beckoning salarymen to come inside. Japanese yen are accepted everywhere.

Why the Japanophilia? In part, it's history. Dalian was occupied by the Japanese from 1905 to 1945. Although few recall those years of brutal colonial rule fondly, the worst memories have faded, while a strong cultural affinity with Japan remains. There are an estimated 100,000 Japanese-speakers in Dalian, and with Tokyo just a three-hour flight away, Japanese tourists flock to Dalian on weekends to stroll the tree-lined streets, play golf along the rocky coastline, and dine on bargain-priced seafood. "Most Japanese feel very welcome in Dalian," says Takashi Ota, a Tokyo-based senior manager at NEC Soft Ltd.

That friendly atmosphere attracts more than golfers and sushi fans. In recent years, Hitachi, Matsushita, NEC, Sony, and other Japanese multinationals have established call centers or software development operations in Dalian. And it's not just the Japanese. GE Capital has 1,100 employees, 80% of them Japanese speakers, providing back-office support for GE companies in Japan. Dell Inc.'s 400 call-center operators provide tech support and process orders from Japan and Korea. And Accenture, BearingPoint, and Hewlett-Packard are producing software for Japanese customers. The trend is

in the early stages: Japanese outsourcing to Dalian reached \$375 million in 2004. But that's double the level from 2000, according to city officials. "Dalian is coming to Japan what Bangalore is to the U.S.," says Chen Ying Sheng, managing director of BearingPoint China (China) Development Center.

Just as in Bangalore, cultural ties are important, but low costs and skilled workers seal the deal. Software engineers start at about \$300 a month, a tenth of what their Japanese counterparts earn. What's more, land in Dalian is cheaper than in Beijing and Shanghai, not to mention Tokyo or Osaka. Dalian has roughly 26,000 experienced software engineers, while its 22 universities and technical institutes churn out 3,800 software engineering grads annually. An additional 8,600 students learn Japanese-language skills hit the job market each year. Dalian's pro-business attitude helps, too. The local government offers generous incentives, including a two-year tax holiday on profits and an 80% reduction in value added taxes.

TALENT COMPETITION

DALIAN'S SUCCESS, though, could be undoing. As more multinationals seek back-office support for their Japanese operations, good employees are increasingly getting poached. Furthermore, salaries are rising—about 25% in the past year for some jobs. Despite the legions of Japanese-speaking grads, some companies warn that they already face a shortage of new hires. "Software engineers and programmers are easy to recruit, but it's difficult to find project managers and others," says Zhang Limin, chief technical officer of Dalian Hi-Think Computer Technology Co., a local software outsourcing company with 1,700 employees.

Dalian has a long way to go before closing the gap on Bangalore. In 2004, outsourcing brought in some \$17 billion in revenues last year. China's outsourcing revenue, in contrast, was just \$600 million last year, according to researcher IDC. But the number is growing rapidly. Outsourcing to mainland China rose by 50% in 2004 and could reach \$4.7 billion by 2009, according to IDC figures. Dalian isn't Bangalore yet, but the hub to create a new Bangalore is there. ■

—By Frederik Balfo
Dalian, with Hi-Think
Tashiro in T





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EDITED BY ROSE BRADY

Syria's Assad: Man On a Tightrope

NO MATTER WHAT THE small pro-regime crowds in the Syrian capital say, being forced to pull Syrian troops out of Lebanon comes as a humiliation for Bashar al-Assad. The 39-year-old Syrian President might have arranged a more dignified exit had he heeded last year's U.N. resolution calling for Syria to end its three

decades-old occupation. Now he finds himself in a predicament. "He is walking a tightrope between the Americans, the Syrian opposition, and the regime hard-liners," says Nadim Shehadi, acting head of the Middle East program at London's Royal Institute of International Affairs.

These days the view from Damascus is disconcerting. American troops are camped across the border on Assad's eastern frontier. Iraqi politicians are furious over what they say is Syrian support for the bloody insurgency. Assad's position in Lebanon, which he hoped to use as a bargaining chip in eventual negotiations with Israel on the Golan Heights, is in doubt. Further south, the Palestinians are once again talking to the Israelis with Washington's sponsorship—leaving Syria out in the cold.

So are Assad's days in power numbered? Although Mideast autocrats are not easily toppled, U.S. pressure has emboldened his domestic critics. After decades of repression, the open opposition remains small. But it is increasingly forthright in saying that Assad has done far too little to open up Syria's political system and economy since succeeding his father in 2000. Syria's leaders "have shown themselves to be incompetent," says Ammar Abdulhamid, a Damascus dissident.

Assad has even more to worry about from the underground, fundamentalist Muslim Brotherhood. It draws on the Sunni Muslim majority's resentment of rule by Assad's minority Alawite sect. Assad also has to keep his eye on military and intelligence chiefs, who hold the keys to power. If these men, many of them Alawites, think

the President is endangering the regime, they won't hesitate to bid him bye-bye.

U.S. Pressure

TO BOLSTER HIS position, Assad recently installed his brother-in-law, Assif Showkat, as military intelligence chief. And Assad has made goodwill gestures to the U.S. Syria recently fingered Saddam's half-brother, Sabawi Ibrahim, and has made efforts to tighten its borders. Bashar has proposed unconditional talks with Israel and shared intelligence on al Qaeda suspects.

But none of these moves has eased the squeeze from Washington, which seized on the anti-Syrian protests in Lebanon after the assassination of former Lebanese Prime Minister Rafik Hariri as a chance to turn the screws on Syria. "Washington and Damascus are on a collision course, and if the U.S. keeps up the pressure this could bring down Bashar," says Eyal Zisser, a Syria specialist at Tel Aviv University in Israel.

For the Bush Administration, which wants to parlay its overthrow of Saddam into a Pax Americana in the Middle East, Assad's troubles look like a blessing. But events are moving so quickly that U.S. policy hasn't been set beyond the aim of getting Syria out of Lebanon. "We haven't figured out a way to deal with Bashar," notes an Administration official. Even though Syria might be a better place without Assad and his Baath Party, the transition could be rough. Want an example of what Syria could be like without the Baath? Look at the violence in Iraq. ■

—By Stanley Reed in London, with Neal Sandler in Jerusalem and Stan Crock in Washington



WORRIED
Assad faces growing internal dissent

GLOBAL WRAPUP

A KEY NEOCON IS TAP FOR THE WORLD BANK

WHEN PRESIDENT George Bush announced on Mar. 11 his nomination of neoconservative Paul Wolfowitz to head the World Bank, many development experts were aghast at the prospect of a U.S. unilateral move heading such a premier institution. But knee-jerk opposition to the Deputy Defense Secretary may be misplaced. Wolfowitz, who is a strong advocate of the Iraq war, has extensive experience with development issues, including stints as ambassador to Indonesia and as dean of Johns Hopkins University's School of Advanced International Studies. He also brings management skills to his new task—which predecessor James Wolfensohn didn't always display. Wolfowitz, 61, whose nomination could run into some European opposition on the World Bank's board, will need all his knowhow to make the agency more accountable and its \$20 billion annual lending program more effective.

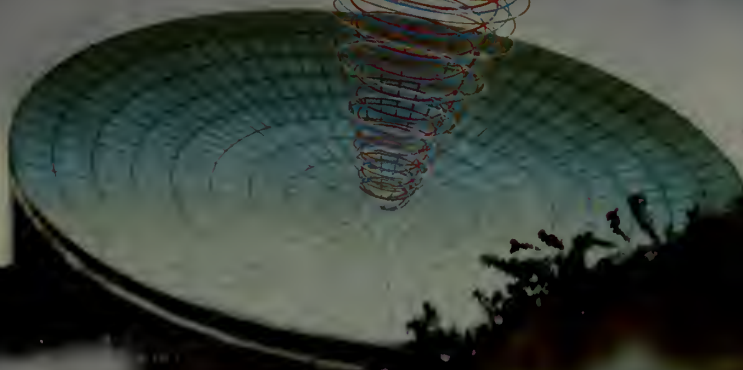
TROUBLE AHEAD FOR CHINESE BANK IPO?

THE RESIGNATION of China Construction Bank's director board chairman, Zhang Enzhong, may cast a shadow over CCB's plans for a multibillion-dollar international listing of its shares as early as this year. The bank announced on its Web site on Mar. 16 that Zhang was leaving for "personal reasons." Hong Kong media reports say Zhang is under investigation for alleged kickbacks linked to its technology procurement. The CCB Web site did not mention the probe and thanked Zhang for his contribution to the bank's development. In an apparent move to reassure observers, the bank said it would further improve corporate governance.



Avaya, a global leader in communication software, systems and services, spun off from Lucent with a legacy infrastructure that, while efficient, wasn't nimble enough to be a competitive advantage. HP partnered with Avaya to implement IT Service Management and HP OpenView, effectively re-deploying existing technology assets. Today, spending is down 30%. Millions have been saved by eliminating unused capacity. And Avaya answers whenever opportunity calls.

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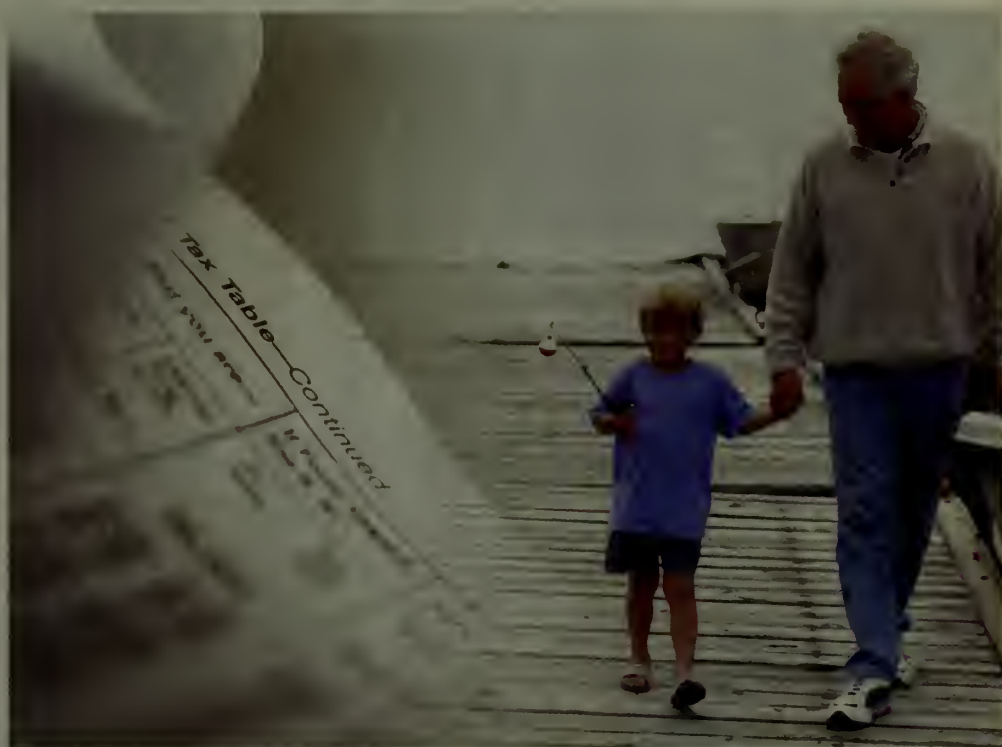

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RETIREMENT PLAN MAKEOVER

These six steps can help you enhance your returns, nip-and-tuck your taxes and retire with that young-enough-to-enjoy-it look.

Subtle changes to your retirement plan today can make a difference of millions of dollars of wealth by the time you retire. Yet many investors put these changes off. Some want to wait to see what the stock market is going to do this month or this year. But wise planning doesn't rely on timing. Others believe that only investors with six-or seven-digit retirement accounts need to think about things like asset allocation, but a 40 year-old with \$20,000 in savings today already controls hundreds of thousands of dollars in potential retirement wealth.

New investment choices, including exchange-traded funds and specialized annuities, make it easier than ever to revamp an underperforming retirement plan and begin building more wealth for tomorrow. Here are six simple tools and strategies to help you get started today.



1. PRIORITIZE YOUR SAVINGS OPTIONS.

Saving for retirement is all about tax advantages—getting as much money as possible into tax-deferred accounts, as soon as possible. Doing so creates a triple compounding effect. You earn a return on your money and a return on that return, plus a third de facto return on money that would have normally gone to pay taxes.

There are dozens of tax-advantaged investments available. Most employees' first choice for retirement savings is an employer-sponsored 401k plan, and rightly so. The benefits of such plans are hard to beat. Contributions are made with pre-tax dollars, which reduces the participant's taxable income. Often, employers provide matching funds for a portion of these contributions.

But contributions to 401k plans in 2005

are limited to \$14,000. The limit for traditional and Roth IRA accounts is a scant \$4,000. Self-employed savers have more options, including SEP, Keogh and Solo 401k plans. Limits for these are more generous, but all of them top out at \$42,000 in 2005. For many those limits will be sufficient. But what about high-income investors who are looking to contribute more, or those with lump sums in taxable accounts who are looking to jump-start their tax-deferred savings?

Annuities have no contribution caps; they offer an unlimited ability to get money growing tax-deferred. There are two basic types. Deferred annuities are designed to help people accumulate money for retirement. Immediate annuities allow those entering retirement to turn a lump sum of savings into a guaranteed stream of lifetime income.

"There's a wide gamut of potential annuity customers, from people in their 40s and 50s who use them to save, to people in their 60s and early 70s who use them to guarantee income in retirement," says John Meyer, senior vice president of New York Life's individual annuity department. "Fewer employers these days offer defined benefit plans. Immediate annuities provide a way for investors to create their own pension plan."

Meyer points out that annuities today offer new features that add convenience, liquidity and new planning possibilities. For example, New York Life's LifeStages income annuities can provide a guaranteed stream of payments for the life of the purchaser and a loved one, and leave a tax-free death benefit for an heir. And new withdrawal options allow holders of the annuity to access cash in case of

RETIREMENT PLAN MAKEOVER

emergency. They can take an advance of six months' worth of payments, or cash in 30% of the remaining value of payments on the fifth, 10th and 15th anniversary of the first annuity payment.

Each of the retirement savings options mentioned thus far requires an additional decision about how the money will be invested. Participants in 401k or self-employment retirement plans as well as IRA holders must choose between stocks, bonds, mutual funds, exchange-traded funds, money market funds and more. Annuity holders have essentially the same choice; they must decide between fixed annuities, which provide set returns, and variable annuities, in which funds are invested in a variety of mutual funds.

Which of these options is best? That decision requires a look at the basics of investment risk.

one for long-term retirement savers. It's the risk that your savings fail to keep up with the reduction in purchasing power brought about by inflation. An annual inflation rate of 5%, for example, will cut the purchasing power of your money in half in 14 years.

Fail to earn more than that on your money, and you're basically guaranteeing a loss, perhaps not in principal, but in purchasing power, which is what really matters. The rate of inflation changes constantly. Currently it's between 3% and 4% per year. Three-year Treasury bonds and CDs currently pay about the same. Most money market accounts pay around 2%.

Over the past 10 years the Standard & Poor's 500 index—it tracks the shares of America's 500 largest companies—has posted an average total return of more than 11% per year. That's why stocks are

2004 and 28.7% in 2003 but lost 22% in 2002. That illustrates market risk—the risk that the overall stock market declines in value, dragging your stocks down with it. Market risk is one of the primary reasons why some investors shy away from stocks. But long-term investors may feel less market risk than they think.

Consider again the S&P 500. Between 1926 and 2004 the index posted negative yearly returns 29% of the time. But looking at a rolling five-year period and the percentage that saw negative returns drops to 12%. For 10-year periods, it's just 3%.

Whether, and how much, an investor should invest in stocks depends on the amount of time they have before they spend the money. For those planning a retirement that's decades off, the risk of not investing in stocks may well exceed the risk of doing so. But what about choosing the right stocks?

Issue-specific risk is the risk that a particular stock or bond you buy produces a lousy return. Picking individual stocks and bonds requires experience and knowledge. For lay investors, the easiest way to reduce issue-specific risk when buying stocks is to buy into a broad basket of individual investments by purchasing a mutual fund or exchange-traded fund.

Investors who are uncomfortable doing that on their own—studies show many are—should use a financial advisor, says Maria Umbach, vice president of marketing at Prudential. "The right financial advisor can help an investor understand the risks and potential rewards of different asset classes, including stocks," says Umbach. "They can help investors manage their expectations as they save for retirement." More on choosing the right advisor in a moment.

3. USE ETFs AS RETIREMENT PLAN

Saving for retirement, remember, is about getting as much money as possible in tax-deferred accounts. But the next best thing may be exchange-traded funds or ETFs. A relatively new investment, ETFs combine the best characteristics of mutual funds and stocks, are tax-efficient and often carry ultra-low internal expenses.

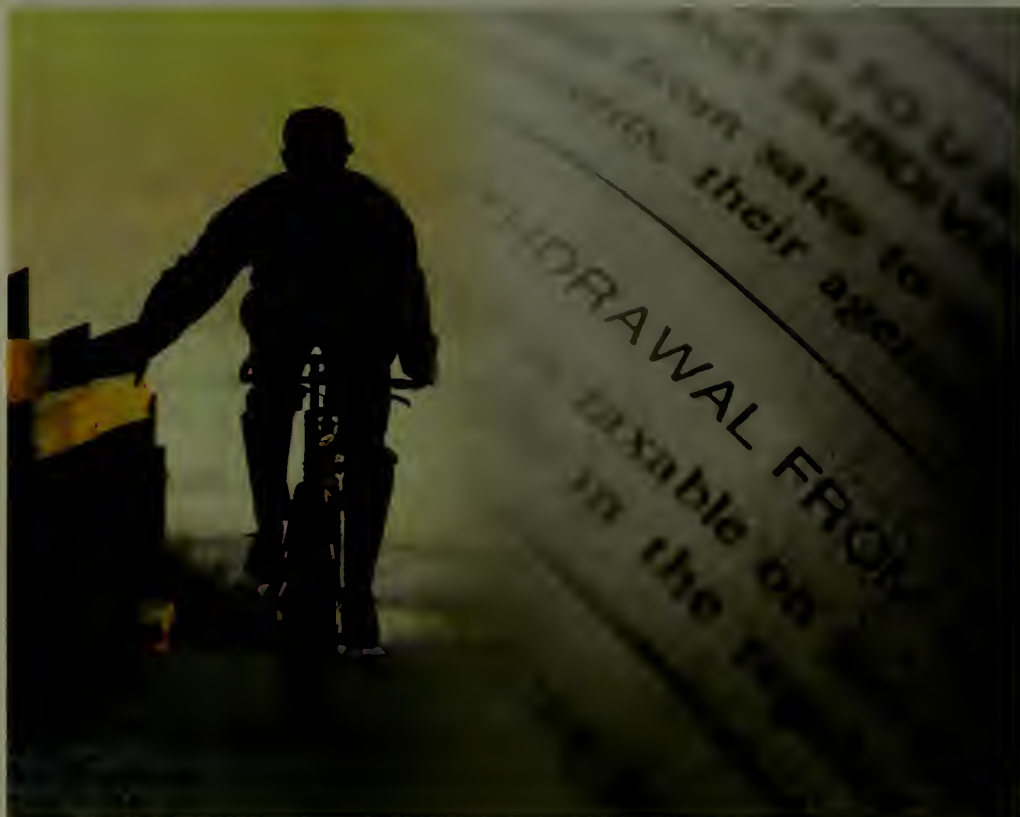
2. MINIMIZE THREE TYPES OF INVESTMENT RISK.

Stocks are riskier than bonds, right? It depends on which type of investment risk you're talking about. Let's look at three types: inflationary, market and issue-specific.

Inflationary risk is perhaps the most overlooked type, and the most important

considered one of the best ways to reduce inflationary risk over long time periods. For 20-year holders, the S&P 500 index has never returned less than the rate of inflation.

But of course, stocks don't provide the same return each year. The S&P 500 index, for example, returned 10.9% in





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RETIREMENT PLAN MAKEOVER

Like index mutual funds, ETFs are baskets of stocks that track stock indexes. There are ETFs that mimic domestic and foreign indexes, stock and bond indexes, sector indexes and more. Like stocks, ETFs trade constantly throughout the day. (They can also be bought on margin and sold short.)

ETF taxes are scant. When mutual funds produce capital gains, they're usually obligated to pay them out to investors. If the funds are held in a taxable account, investors will have to pay taxes on those distributions. ETFs generally pay gains distributions only when changes are made to their underlying indexes. That means that investors will for the most part pay taxes only on dividend distributions.

The S&P 500 index, recall, returned more than 11% annually over the past 10 years. But less than 2% of that return was in the form of dividends. So ETF shares miss out on the bulk of taxes until they're sold. They're also cheap. Domestic stock ETFs offered by Vanguard, for example, carry expense ratios (expenses as a percentage of assets) of just 0.15%, vs. 0.20% for their comparable index mutual funds.

4. THERE'S A TIME TO BUY, AND A TIME TO BUY MORE.

The old Wall Street axiom, "buy low, sell high," does most investors little good. It's like saying "get rich, not poor." Investors know they should buy low. The question is, how?

For most investors, there is exactly one way to ensure that they buy shares of a stock, mutual fund, ETF or annuity at a lower-than-average price. It's called dollar cost averaging, and it couldn't be easier. All that's required is for an investor to make regular, periodic contributions to their investments in steady dollar amounts.

Consider four months' worth of regular \$500 contributions into a mutual fund. In the first month the share price is \$10, so their contribution buys 50 shares. In the next month the price increases to \$12, so they buy 41.7 shares. In the third month, the price falls to \$8, so they buy 62.5 shares. Finally, the price returns to \$10, and the investor

buys another 50 shares.

What was the average share price during the four-month period? Average the four values and you get a share price of \$10. How much did the investor pay? Divide the total dollar amount spent (\$2,000) by the number of shares bought (204.2). You get \$9.79 per share. The investor bought at a lower-than-average price without even trying, because he or she bought more shares at the lower price than at the higher one.

Implementing the strategy in your own portfolio is easy. Employer-sponsored plans do it automatically, since steady dollar amounts are deducted from each of your paychecks and invested. Most mutual funds and brokers allow you to make automated, regular contributions, which can be deducted from your bank account.

"Our periodic investment program is particularly popular with retirement investors," says Kevin Finn, senior vice president of core brokerage product development at T. D. Waterhouse. The program allows investors to deduct as little as \$100 per month from their bank accounts to add to a mutual fund. "It lets you ride out market fluctuations and stay disciplined," says Finn.

5. ROLLOVER, AND FETCH TOP RETURNS.

When 401k participants (and, in most cases, participants in 457 and 403b plans, which are retirement plans most often offered to government workers and teachers, respectively) leave their employers, they have the option of transferring their plan assets into an IRA. It's called a rollover, and it's usually a good idea, provided you make sure the money is indeed treated as a tax-free rollover, and not as a taxable distribution. Employer plans offer a choice of perhaps a few dozen mutual funds, while IRAs offer near-limitless investment choices.

"IRA rollover accounts provide access to mutual funds, stocks, bonds, ETFs—a full range of investment products," says T.D. Waterhouse's Finn. "They give you full discretion over how your retirement funds are invested."

Annuities are another choice for rollover funds. New York Life's Meyer says annuities are helpful for meeting required minimum distribution rules that, for traditional and rollover IRAs, kick in at age 70 1/2. "An IRA immediate annuity provides lifetime income, plus it satisfies the minimum distribution requirement because payments are based on the investor's life expectancy."

The vast number of investment choices available inside an IRA can help investors to enhance their returns or reduce the risk. But for many investors, the responsibility of managing a large rollover account is daunting. Selecting from a handful of 401k mutual funds, after all, can be complicated enough. Choosing between tens of thousands of mutual funds, stocks and bonds will, for some, require professional help.

6. KNOW WHEN TO GET HELP.

A good financial advisor can help you save for retirement and make the right investment choices, and also show you how to pay for things like a child's education or home renovation.

Financial advisors should be knowledgeable, and have access to a broad range of investments and research. Even the key to choosing a good advisor, says Prudential's Umbach, is to find one who listens.

"Look for someone who wants to understand your risk tolerance, and who responds to your needs instead of pushing a cookie-cutter investment," says Umbach. "It has to be a needs-based approach. The right advisor will ask plenty of questions."

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The Immelt Revolution

He's turning GE's culture upside down, demanding far more risk and innovation

DESPITE HIS AIR OF EASY-going confidence, Jeffrey R. Immelt admits to two fears: that General Electric Co. will become boring, and that his top people might act like cowards. That's right: cowards. He worries that GE's famous obsession with bottom-line results—and tendency to get rid of those who don't meet them—will make some execs shy away from taking risks that could revolutionize the company.

Immelt, 49, is clearly pushing for a cultural revolution. For the past 3½ years, the GE chairman and CEO has been on a mission to transform the hard-driving, process-oriented company into one steeped in creativity and wired for growth. He wants to move GE's average organic growth rate—the increase in revenue that comes from existing operations, rather than deals and currency fluctuations—to at least 8% from about 5% over the past decade. Under his former boss, the renowned Jack Welch, the skills GE prized above all others were cost-cutting, efficiency, and deal-making. What mattered was the continual improvement of operations, and that mindset helped make the \$152 billion industrial and finance behemoth a marvel of earnings consistency. Immelt hasn't turned his back on the old ways. But in his GE, the new imperatives are risk-taking, sophisticated marketing, and above all, innovation.

This is change borne of necessity. The Welch era reached its zenith in the booming, anything-goes economy of the late 1990s. Back then, GE always seemed

to beat the consensus forecasts by a penny a share—and investors felt no burning need to figure out exactly how they did it. Immelt has no such luxury. With a slower-growing domestic economy, less tolerance among investors for buying your way to growth, and more global competitors, Immelt, like many of his peers, has been forced to shift the emphasis from deals and cost-cutting to new products, services, and markets. Any other course risks a slow descent into irrelevance. "It's a different era," says Immelt, a natural salesman who still happily recounts the days when he drove around his territory in a Ford Taurus while at GE Plastics. He knows the world looks to GE as a harbinger of

you banish some long-cherished notions and beliefs. Immelt has welcomed outsiders into the highest ranks, making one, Sir William M. Cass, vice-chairman. That's a serious move with GE's promote-from-within policy. Immelt is pushing hard for a more global workforce that reflects the communities in which GE operates. Immelt is also encouraging his homegrown managers to become experts in their industries rather than just experts in managing. Instead of relying on execs who barrel time to position a family photo on their desk before moving on to the next executive assignment, he's diversifying the top ranks and urging his lieutenants to stay put and make a difference where they are.

Most of all, Immelt has made it a need to generate blockbuster ideas rather than an abstract concept. In true fashion, he has engineered a quantifiable and scalable process for coming up with money-making "eureka!" moments. While Welch was best known for the annual Session C meetings during which he personally evaluated the performance of GE's top several hundred managers, Immelt's highest-profile new gathering is the Commercial Council. Immelt leads a group of roughly a dozen top sales and marketing executives, including unit heads such as GE Consumer Finance CEO David R. Nissen. The members meet by phone meetings every month and each quarter to discuss growth strategies, think up ways to reach customers, and evaluate ideas from the senior ranks.

aim to take GE out on a limb. "We have launched us on a journey to become one of the best sales and marketing companies in the world," says Nissen, who describes the meetings as collegial and more experimental than other GE gatherings.

This is no free-for-all, however. Business leaders must submit at least three "Imagination Breakthrough" proposals per year that ultimately go before the council for review and discussion. The projects, which will receive billions in funding in the coming years, have to take into a new line of business, a geographic area, or customer base. And each one has to give GE incremental growth of at least \$100 million.

Such change can be scary stuff for folks steeped in Six Sigma, who were to believe that if you made your numbers and were prepared to uproot your family every year or two, you had a shot at the top rungs. Now they're being

Culture Shock

How CEO Immelt is trying to shift the GE mindset:

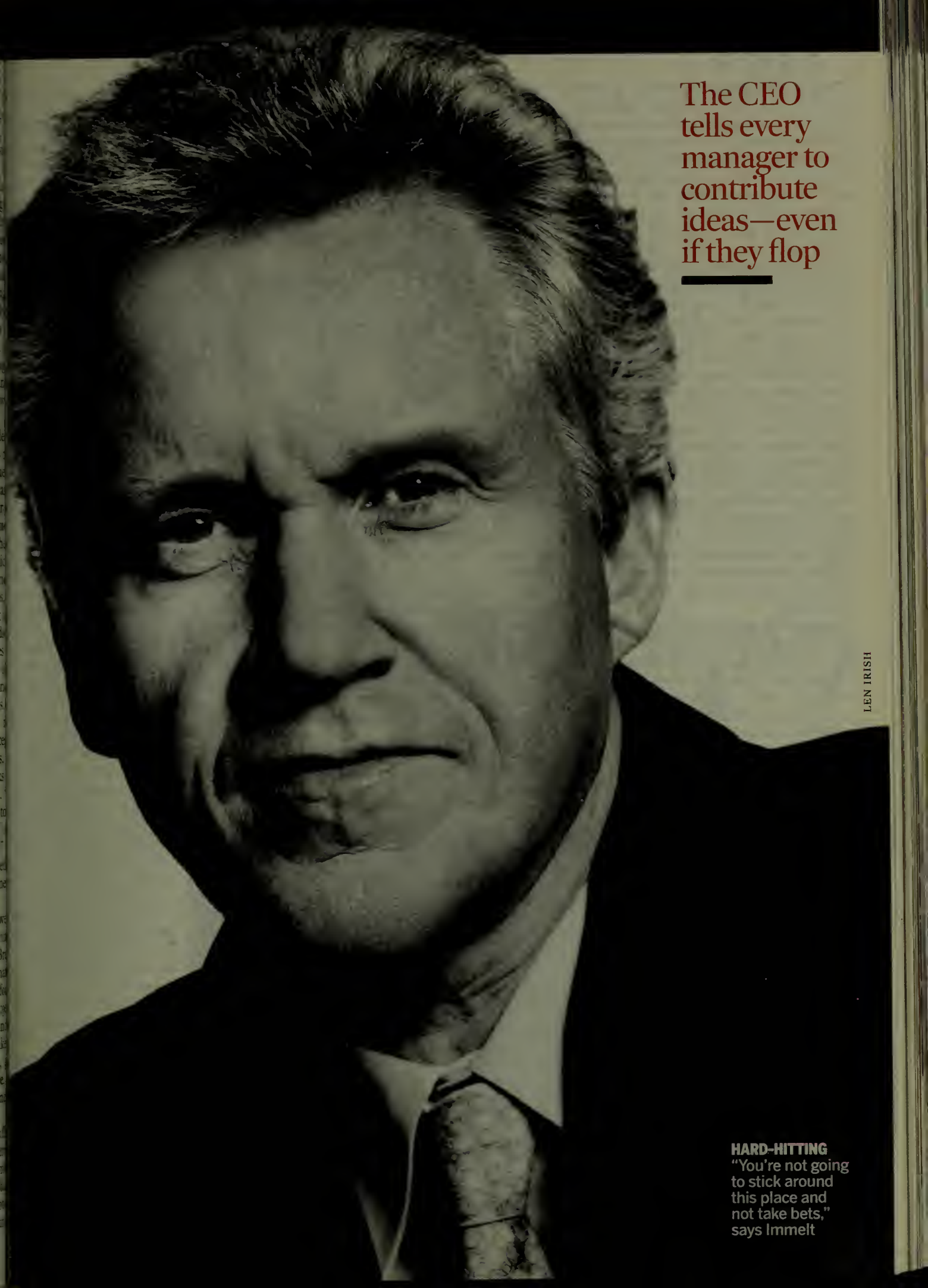
Link bonuses to new ideas, customer satisfaction, and sales growth, with less emphasis on bottom-line results

Spend billions to fund "Imagination Breakthrough" projects that extend the boundaries of GE

Rotate executives less often, and bring in more outsiders to create industry experts instead of professional managers

future trends, says Ogilvy & Mather Worldwide Chief Executive Rochelle B. Lazarus, who sits on the GE board. "He really feels GE has a responsibility to get out in front and play a leadership role."

So how, exactly, do you make a culture as ingrained as GE's sizzle with bold thinking and creative energy? To start,



The CEO
tells every
manager to
contribute
ideas—even
if they flop

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HARD-HITTING
"You're not going
to stick around
this place and
not take bets,"
says Immelt

asked to develop real prowess in areas such as creativity, strategy, and customer service that are harder to measure. They are being told to embrace risky ventures, many of which may fail. Immelt's GE can be seen as a grand experiment, still in its early days, to determine whether bold innovation can thrive in a productivity-driven company.

To inspire the fresh thinking he's looking for, Immelt is wielding the one thing that speaks loud and clear: money. The GE chief is tying executives' compensation to their ability to come up with ideas, show improved customer service, generate cash growth, and boost sales instead of simply meeting bottom-line targets. As Immelt puts it, "you're not going to stick around this place and not take bets." More concretely, 20% of 2005 bonuses will come from meeting pre-established measures of how well a business is improving its ability to meet customer needs. And while he hasn't exactly repudiated Welch's insistence that managers cull the bottom 10% of their staff, insiders say there's more flexibility, more subjectivity to the process. Risking failure is a badge of honor at GE these days.

To lay the groundwork for an organization that grows through innovation, Immelt took steps early on to rejigger the GE portfolio. He committed to sell \$15 billion of less profitable businesses such as insurance, while shelling out more than \$60 billion in acquisitions to dive into hot areas such as bioscience, cable and film entertainment, security, and wind power that have better growth prospects. In doing so, he pared the

low-margin, slower-growth businesses like appliances or lighting, which he diplomatically calls "cash generators" instead of "losers," down to 10% of the portfolio, from 33% in 2000. Nicole M. Parent of Credit Suisse First Boston is impressed with "the way they have been able to evolve the portfolio in such a short time" and with so little disruption. "This is a company where managers will do anything to achieve their goals."

Good thing, as their back-slapping chief is now looking for "those things that grow the boundaries of this company." He's confident that the new business mix and growth incentives are already paying off. At GE's annual gathering of its top 650 executives in Boca Raton, Fla., in January, he insisted that "there's never been a better day, a better time, or a better place to be [at GE]!" Strong words in a company that stretches back 127 years to founder Thomas Edison. After an 18% jump in revenues and earnings in the fourth quarter, to \$43.7 billion and \$5.4 billion, respectively, Immelt predicts up to 17% earnings growth and 10% sales gains for all of 2005, with double-digit returns through 2006. While economists scratch their heads over the next quarter, Immelt is promising two years of explosive growth. No wonder Sharon Garavel, a quality leader at GE Commercial Finance says that, at Boca, "everyone was talking about a \$60 stock price," or about \$24 more than its current price.

The changes are tough on the many who aren't "dreamer types"

That in itself may stretch of the imagination for now, but Immelt is to recast the company decades to come. spending big bucks to the kind of infrastructure that can equip and foster an army of dreamers. means beefing up GE search facilities, creating something akin to a global brain trust that GE can

to spur innovation. He has sunk \$100 million into overhauling the company search center in Niskayuna, N.Y., forked out for cutting-edge centers in Bangalore, Shanghai, and Munich.

Globalizing research has allowed GE to get closer to overseas customers. The simple fact is that most of GE's growth will come from outside the U.S. Immelt predicts that developing countries will account for 60% of the company's growth in the next 10 years, vs. about 20% for the past decade. But he is also spreading best practices to lethargic economies such as Germany. After a 2002 meeting with German Chancellor Gerhard Schröder, Immelt forced his notion that GE could be a success more in that country, Immelt decided to open the Munich center. As Immelt explains, "there's no place in GE where you feel more like a loser than in Germany. You have Siemens and Philips, and haven't been that good." By July, 2003, a new center was up, and the results were immediate. According to Nani Bec Falco, CEO of GE International, the company saw a 21.5% growth in German-speaking markets last year from 2002.

Now that Immelt has repositioned the portfolio and added resources, the main objective is to drive more immediate growth of the businesses he already has. That's where the Innovation Breakthroughs center in. Over the past 18 months, Immelt has agreed to invest \$5 billion in 80 projects that range from creating jet engines to overhauling the brand image of 3,000 consumer-financial institutions. The hope is that the first lot will generate \$250 million in revenue by 2005, cheap, if it works, when consider what it would cost to acquire something like the outside with that level of sales. In the next year

Shuffling The Portfolio

Immelt has spent more than \$60 billion to bolster GE's mix of businesses. Some new capabilities:

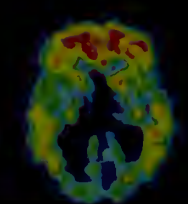
Media Content

Buying Universal gave GE a rich library, film studio, cable networks, and theme parks. Bravo and Telemundo help, too.



Bioscience

With Amersham, GE can bring diagnostics down to the cellular level and be a leader in personalized medicine.



Security

GE bought its way into fire safety and industrial security with Edwards Systems. Ion Track and InVision gave it entrée into homeland security, from bomb detection to screening for narcotics.

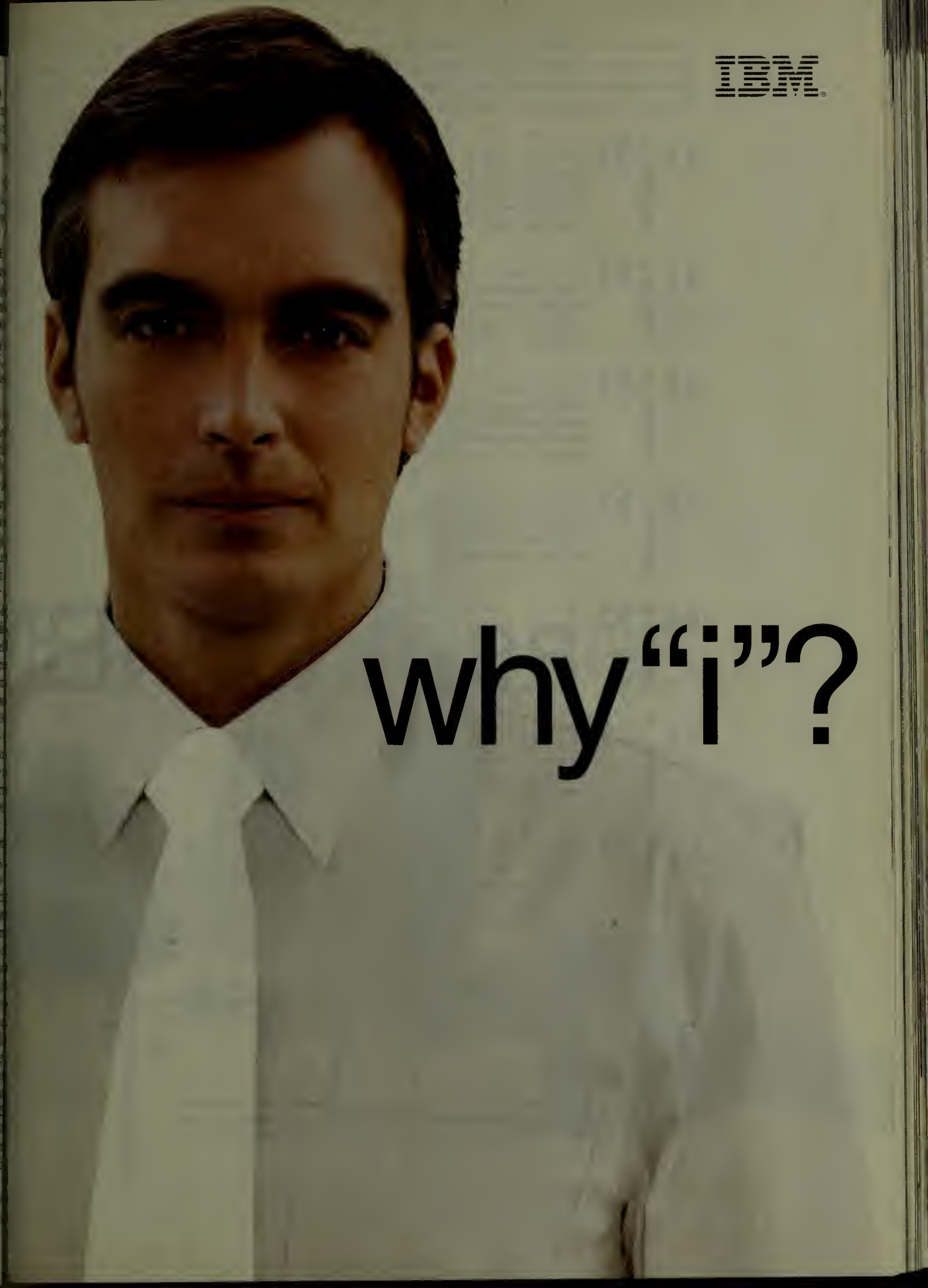
Water

Buying Ionics and Osmonics gets GE into desalination, fluid filtration, and other water-processing services. The goal: to increase the availability of clean water around the world.

Renewable Energy

GE moved into solar and wind power and biogas with acquisitions such as Enron Wind.



A man with dark hair, wearing a white dress shirt and a white tie, is looking directly at the camera. The background is a light, textured surface.

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Greif, a world leader in industrial packaging, has experienced substantial growth through acquisitions. Their iSeries servers helped them simplify an increasingly complex IT infrastructure. Consolidating on iSeries servers helped them significantly reduce their IT infrastructure costs.

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The USTA uses an iSeries server to run distinct applications simultaneously on a single server, simplifying management of apps that previously ran on three different servers. This lets them post real-time scores to USOpen.org, which is viewed by millions of fans around the world.

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Ineco Auto, an Italian performance auto dealer, says their iSeries server handles like a dream. The iSeries server was simple to implement, thanks to its integrated and preconfigured design.

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Bank Mandiri, in Indonesia, needed to simplify their systems after merging with four different institutions. Now a single iSeries 840 handles nearly seven million accounts at 788 branches.

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as in impressive.

The Asian Art Museum, in San Francisco, simplified business operations, increased staff productivity and enhanced the overall visitor experience with the help of iSeries servers, which will be remembered throughout the ages as helping keep operation costs low.

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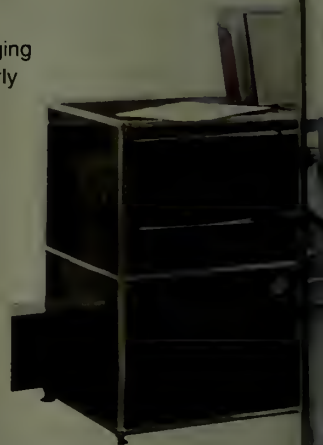
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Management Strategies

Immelt expects to have 200 such cuts under way.

The pressure to produce could not be intense. Many of the company's 600 workers weren't exactly hired to sort of a diverse, creative, fleet-footed group of visionaries who are acutely sensitive to customers' needs. "These guys just aren't dreamer types," says one consultant who has worked with the company. "It almost seems painful to them, like a loss of time." Even insiders who are openly euphoric about the changes under Immelt admit to feeling some fear in the depth of their guts.

This is a big fundamental structural change, and it can be tough," says T. Bossidy, CEO of GE Commercial Equipment Financing, who is reorganizing his sales force so that each person represents all of GE to particular customers. Susan P. Peters, vice-president for executive development, even talks about the need for employees to "reconceptualize" themselves. "What we have been to date isn't enough for tomorrow," she says. Ouch.

Immelt, the best managers are marketers and not just great operators. That's a rethinking of GE's long bias that winning products essentially sell themselves. Beth Comstock, who was appointed chief marketing officer three years ago with the mission of turning the company's marketing expense, says that when she started, a number of insiders were skittish about the new agenda: "Everyone thought, 'I've never got into sales and marketing to be a part of this company?'"

Well, yes. Comstock is trying to elevate the role of marketing throughout GE. She helped develop a commercial leader-ship program that sends the best and brightest marketers around the organization for two intensive years, much as GE's corporate audit staff has long done on the other side. The auditors were important in maintaining financial discipline under Immelt. Now, GE has initiated new courses in marketing, as well as ones on how to kick idea generation. Some executives have also taken to holding "idea jams," where people from diverse businesses brainstorm. Within GE Energy alone,

there are "growth heroes," who are held up as emblematic of where the company wants to go, a "virtual idea box" to spur brainstorming via the Web, and "Excellerator awards" for the development of ideas. The jargon may smack of classic GE, but the approach is novel. "This is about unlocking the curiosity, yet having the rigor stay intact," says Comstock.

In this era, marketing is not just a matter of producing edgier commercials or catchier slogans. It means getting outside the company to understand markets and customers. Among other things, GE's top marketing executives have spent a lot of time examining the practices of companies such as Procter & Gamble Co., which let them spend time last November in "The GYM" where strategies and issues are debated, examined, and maybe even solved. "The idea is to enhance a team's creative thinking," says P&G spokesman Terry Loftus. GE staffers also spent time at FedEx Corp., which has exceptional customer service. Welch did the same thing in benchmarking Motorola Inc. when he delved into Six

Sigma, but the external focus is even stronger now.

Immelt wants his managers to lead industries rather than merely follow demand. Take the company's move to create a cleaner coal plant—another Imagination Breakthrough—before its customers were even asking for it. GE initiated the push after acquiring ChevronTexaco Corp.'s gasification-technology business last year. Immelt and GE Energy CEO John G. Rice brought together big power customers and experts on subjects such as climate change at GE's education center in Croton-on-Hudson, N.Y., last July to debate where the industry would be in 2015. James E. Rogers, chairman and CEO of public utilities giant Cinergy Corp., was shocked to hear Immelt talk about the need to generate electricity with far fewer emissions—a touchy subject in an industry that still burns a lot of coal. "He was unafraid to articulate a point of view that his customers might not share," says Rogers, whose company burns 30 million tons of coal a year.

What convinced Rogers to partner

with GE and Bechtel Corp. on a cleaner coal power plant was the prospect of having an integrated package managed by GE. Instead of forcing Rogers to license the technology and figure it out himself, GE in partnership with Bechtel will design and implement the plan, while Cinergy will provide and help develop the site. GE's promise: that the cleaner-burning plant will soon become competitive with pulverized coal and that GE will handle any hiccups in the process. "I like the way they're thinking about the future," says Rogers. "They're going to make this work."

OUTSIDERS' INFLUENCE

BUT THERE'S A LIMIT to how much Immelt can transform his own people. A key strategy—and one that amounts to a gut punch to the culture—involves bringing in more outsiders. In sales and marketing alone, GE has hired more than 1,700 new faces in the past few years, including hundreds of seasoned veterans such as David J. Slump, a former ABB Group executive who is the chief marketing officer of GE Energy. "I just didn't think outsiders would do well here," says Slump, who was surprised at the unit's openness to changing its ways, though one of the senior executives did warn him about coming off as "too intense." That said, he was also amazed at the lack of attention to marketing when he arrived—with no marketers among the senior ranks and no real sense of strategy beyond the occasional ad or product push. Slump felt needed.

Immelt is also looking for more leaders who are intensely passionate about their businesses and are experts in the details. "I want to see our people become part of their industries," he says. No one represents Immelt's vision of what a GE leader should be better than Bill Castell—who has spent his entire career in one industry and who has rarely, if ever, focused on maximizing profits. The cerebral Brit was heading up diagnostics-and-bioscience giant Amersham PLC when Immelt acquired it—after much wooing—for \$10.7 billion last year. Not only did Immelt make Castell head of the new \$14 billion GE Healthcare, he named him a vice-chairman of GE and located the unit's headquarters outside the U.S., in the English village of Chalfont St. Giles.

Castell is quite unlike the archetypal GE executive. He's totally immersed in his industry, a leading thinker on the future of personalized medicine who will never head up a business based on jet engines



GE has made a break with its promote-from-within tradition

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(having what it takes to run a business: priceless)

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CHEEKY—AND LEGGY Taylor, Skaist-Levy, and companion

To Live and Thrive in L.A.

Juicy Couture's founders are spinning gold from Valley Girl "casual chic"

THERE ARE THE CONVENTIONAL measures of success in business: healthy profits, high stock prices, happy employees. Then there's the way 44-year-old Gela Taylor and 41-year-old Pamela Skaist-Levy, the two women who founded Juicy Couture, the very L.A. line of clothes, measure success: "We had our biggest honor this year," says Taylor. "We're Barbies now." That's right. Mattel Inc. designed dolls based on the Juicy ladies, dressed in their signature sweat suits, pet dogs at their sides.

It doesn't get much better than that for this pair, who often do wear matching outfits, call each other "Fluffy," and can take much of the credit for bringing L.A.'s casual chic to the rest of the world. Juicy clothes are laid back, sometimes cheeky, and priced just this side of outrageous. Ripped jeans with a rhinestone

heart on the front sell for \$178; a hooded sweatshirt lined with rabbit fur goes for \$395. And, although you won't hear this from them, paying more helps account for the 4% rise in U.S. apparel sales in 2004, to \$173 billion, the first increase in three years. "People are identifying with that affluent celebrity lifestyle," says Marshal Cohen, an analyst at market researcher NPD Group Inc. "Everybody wants to go to the gym with Madonna, or at least look like they did."

WORKING OUT WELL

JUICY COUTURE IS also a rare example of a corporate takeover that has worked. Liz Claiborne Inc. acquired the company in April, 2003, for what Skaist-Levy calls a juicy price: \$53 million plus an additional sum based on future earnings, which Claiborne estimates could reach \$92 million. Juicy Couture has become one of Claiborne's fastest-growing divi-

commercial finance. Nor is he pursuing a black belt in Six Sigma or losing sleep over making his numbers. "People are surprised at first that I didn't tend to talk about the quarter," admits Immelt. Yet Immelt loves him. "I want managers to have the kind of curiosity that Bill has, his passion for the industry," he says. "He understands where the market is going." This is, after all, a man known to call up his boss and wax poetic about an angiogenesis marker that he hit the marketplace for 10 years.

deepen expertise, focus on the job, and get the job done.

Imagine how long that conversation would have lasted with Welch. To encourage that kind of expertise and passion in the rest of his organization, Immelt is urging people to stay in place longer to build stronger relationships with customers and markets. GE Energy's Immelt—a hotshot who is emblematic of the old system, in which a great GE manager could parachute onto the scene to turn any business into gold—that the idea of staying put takes adjustment. "There was always a sense of pressure in the midlevel ranks that if you weren't moving every year, something was wrong," says Immelt. He now says he likes the fact that he has been in one place for four years, because he's developing a deep knowledge.

Investors are still waiting to see whether GE's evangelizing chairman can truly make his company grow faster than the world around it. Some of his fans think that GE's momentum has more to do with the overall economy than with innovation. Says Steve Roukis of MassMutual Advisors, which owns 2 million GE shares: "If you have a revolutionary decade of growth around the world, who's going to be there to capture it? GE."

Jeff Immelt wants to capture it, drive it, make it his own. For reinventing GE is the only way to let his company dominate this century as much as it led the one before. ■

—By Diane Brady in Fairfield, Conn.

BusinessWeek online For more on GE, visit www.businessweek.com/extras, including a Q&A with Jeff Immelt.

PeopleDesigners

sions. Since the deal, Juicy revenues have quadrupled and are nearing \$200 million. And while the number of retailers that carry the brand remains steady (1,400 worldwide), Juicy has been able to get into swimwear, shoes, sunglasses, jewelry, and handbags. Sweat suits, the item that made them famous and is now knocked off by everyone from Wal-Mart Stores Inc. to Prada, make up half of Juicy's sales, down from 70% two years ago.

In October, Juicy opened its first store, in Las Vegas. Sales top \$1,000 per square foot, three times the industry average. Five more stores are planned this year. "The backing from Claiborne has allowed them to move into new markets much faster," says Frederick Schmitt, an investment banker at Sage Group LLC in Los Angeles who helped negotiate the sale.

Another plus: Claiborne took over tasks the founders weren't so fond of—accounting, manufacturing, and distribution—and left the designing and marketing to them. This is part of Claiborne's strategy of buying fledgling retailers' brands to compete with discount and specialty stores. Acquisitions helped Claiborne's earnings climb 12% last year, to \$313 million, on sales of \$4.6 billion.

The relationship has had its rocky moments, though. Last year, Claiborne Executive Vice-President Angela Ahrendts got word that Juicy was planning to give



DOLLED UP Mattel's latest Barbies are based on the Juicy ladies

away condoms with its men's blazers. She didn't think that exactly jibed with Liz Claiborne's more traditional sensibility, so she called Taylor and Skaist-Levy to "get inside their thought process."

Which was: It seemed funny. Ultimately the pair gave up on the notion because it proved impractical, they say, not because of any corporate kibosh. Now Ahrendts can magnanimously say of the two: "Anything the consumer sees, they control. Their inspiration is totally their own."

WHAT ARE "MARGINS"?

TAYLOR AND Skaist-Levy are still totally into their ditzzy Valley Girl image. Frank Doroff, top women's sportswear buyer at Bloomingdale's, says Taylor pretends not to know financial terms such as margins and dollars per square foot. Taylor adds: "I asked him: 'Do you have a department store dictionary?'" Doroff says it's endearing, and sounds like he means it.

The pair have also introduced a little Paris Hilton-esque attitude into the conservative Claiborne organization. At a corporate retreat two years ago, Taylor and Skaist-Levy were asked by a colleague if they would ever design a moderately priced line. They looked at each blankly. Then Taylor replied: "What's that?"

The Juicy founders met at a friend's clothing store in Los Angeles years ago. Taylor was a struggling actress with a baby on the way. Skaist-Levy was a fashion school grad, was designing hats. Their first creation was maternity jeans: They spent \$200 on an elastic to some old Levi's and sold at maternity clothes stores. After a photograph of actress Melanie Griffith in their jeans appeared in *Glamour*, the jeans took off. Now their approach to celebrity endorsements is a little more calculated. Juicy Couture spends nothing on traditional advertising, preferring to give thousands of free outfits to the famous as well as to fashion editors and stylists every year. "Anybody can buy an item in *Vogue*," Skaist-Levy explains.

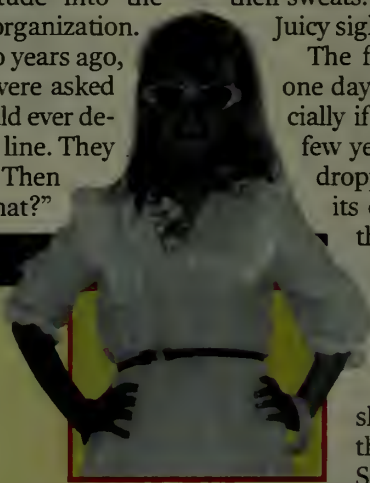
Maternity jeans aside, it was the invention of the sweat suit in 2001 that drew the world's attention. It was cut to show curves, came in pastel colors and used fabrics such as velour and terry cloth that cost about \$200. Later, they splashed the word "Juicy" across the rear end. Celebrities such as Britney Spears and Jennifer Lopez wore the sweat suits everywhere. Taylor says she realized they had created a fashion phenomenon one afternoon standing on Rodeo Drive in Beverly Hills. Women on all four corners were wearing their sweats. "It was what we call a Juicy sighting," she says.

The fashionistas, of course, got one day tire of Juicy Couture, especially if it's available everywhere. A few years ago, Barneys New York dropped Juicy, sensing it had lost its exclusivity. The store pulled the line back fast, though. "Our customers kept asking for it," says Terence Gorman, the women's sportswear buyer at Barneys.

The Juicy take on maternity shoppers is simple enough: the company's warehouse. Skaist-Levy holds up a handbag, intended to be worn from a belt loop or one of the bigger purses. "Our customers are addicted to sweat suits," she says. "They need stuff out of their stuff."

That's why the pair say they'll never retire. "It's going to be Juicy forever," Skaist-Levy says. And Barbie's will be wearing robes and slippers. ■

—By Christopher Paul
in Los Angeles with Na
Byrnes in New



BIOS

Gela Taylor and Pamela Skaist-Levy

They call each other "Fluffy" and often dress alike.

BORN Taylor (left) on Nov. 5, 1960, in Corning, New York. Skaist-Levy (right) on June 9, 1963, in Encino, Calif.

BACK STORY After receiving a theater degree from Carnegie Mellon, Taylor had bit parts in the movie *Body Double* and the TV show *Hill Street Blues*.

Skaist-Levy graduated from the Fashion Institute of Design & Merchandise in Los Angeles and then worked at West Hollywood boutique Fred Segal designing windows.

POSITION They run Juicy Couture, which Liz Claiborne acquired in April, 2003,

for \$53 million plus an additional payout based on future earnings.

ONE SECRET TO SUCCESS IN THE CORPORATE WORLD Use the mute button during conference calls.

CELEBRITY THEY'D MOST LIKE TO DRESS George W. Bush. "I want him to wear our King of the World tank shirt. His daughters wear Juicy," says Taylor.

FAMILY Taylor and second husband, Duran Duran bass player John Taylor, have three kids between them. Skaist-Levy and her husband, producer Jeffrey Levy, have one child.





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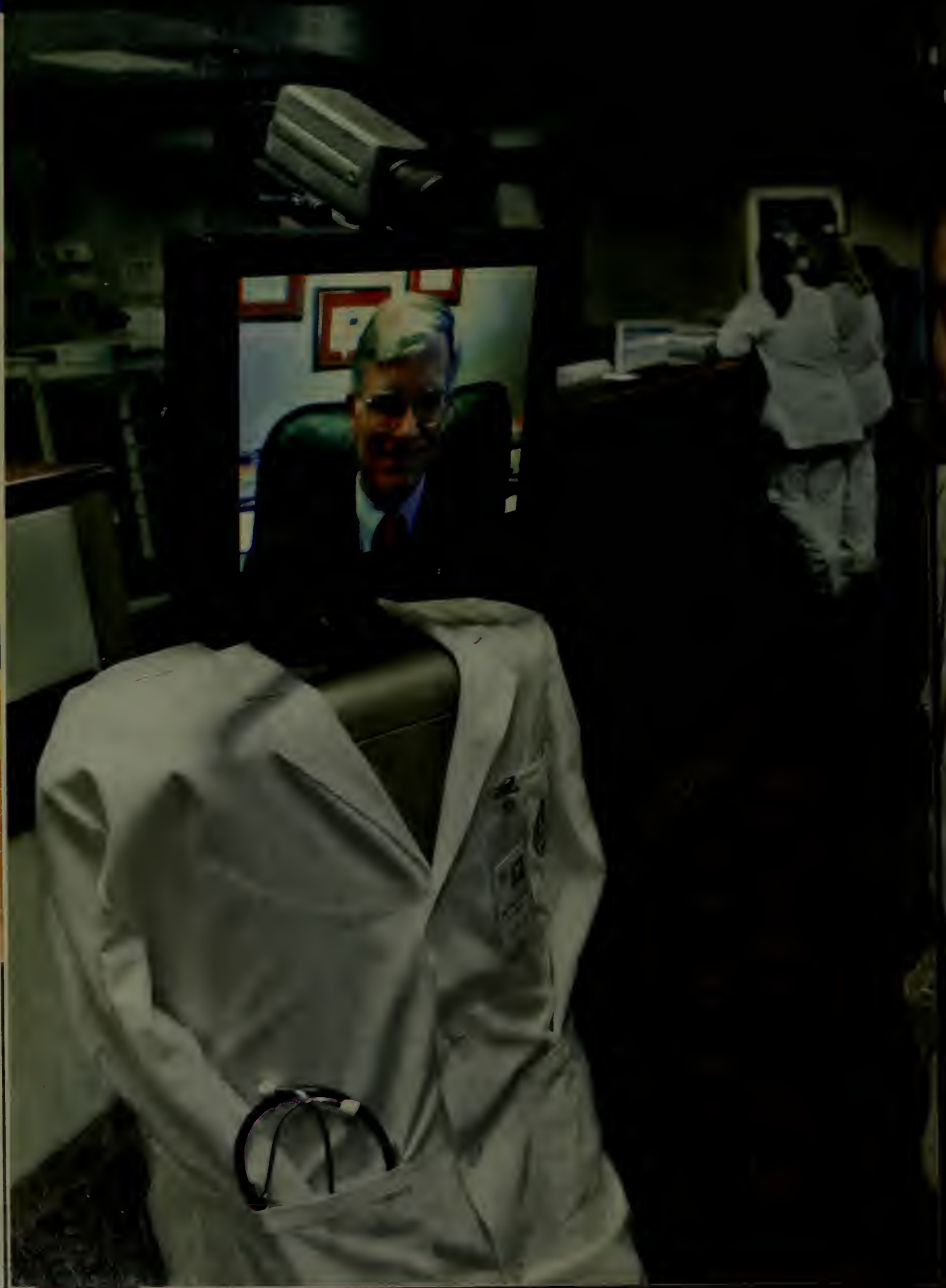
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SPECIAL REPORT





The Digital **HOSPITAL**

How info tech saves lives and money at one medical center. Is this the future of health care?

**BY TIMOTHY J. MULLANEY
AND ARLENE WEINTRAUB**

PETER A. GROSS HAS BEEN A DOCTOR FOR 40 years, rising up the ranks to become the chairman of internal medicine at Hackensack University Medical Center in Hackensack, N.J. But one day this winter, a homeless man checked in to the hospital with HIV, and Gross made a decision that could have seriously harmed his patient. He chose to give the patient an HIV drug, tapping a request into a hospital computer and zapping it off to the two-year-old digital drug-order entry system. Moments later he got back a message he never would have received before the system was in place: a warning that the drug could mix dangerously with an antidepressant the patient was already taking. Gross got on the phone to figure out the problem, eventually asking the man's psychiatrist to reduce the dosage of his antidepressant. "There's no way I would have picked that up," Gross says. "It was totally unexpected."

Scenes like this are unfolding across the country, providing a glimpse into the potential of information technology to transform the health-care industry. Hackensack is one of the nation's most aggressive tech adopters. Millions of dollars in investments have paid for projects well beyond the online drug system that tipped off Gross. Doctors can tap an internal Web site to examine X-rays from a PC anywhere. Patients can use 37-inch plasma TVs in their rooms to surf the Net for information about their medical conditions. There's even a life-size robot, Mr. Rounder, that doctors can control from their laptops at home. They direct the digital doc, complete with white lab coat and stethoscope, into hospital rooms and use two-way video to discuss patients' conditions.

Whimsical? Maybe, but Hackensack's results are perfectly serious. Patient mortality rates are down. Quality of care is up. At the same time, productivity is rising. While these are early days

MOBILE VIDEOCONFERENCING From virtually anywhere in the world, physicians can make their hospital rounds with the help of Mr. Rounder, a life-size robot. Using laptops with joysticks and Web links, doctors drive the robot around the hospital to confer by remote video with patients and other doctors.

and plenty of hurdles remain, the hospital has no doubts that its technology investments are making the difference. "We could never become a top hospital unless we were tops in tech," says John P. Ferguson, the hospital's chief executive.

Is this the health-care industry's future? It would be a startling reversal. For years health care has missed out on the huge benefits that information technology has bestowed upon the rest of the economy. Hospitals were not only cheapskates when it came to investing in computers and Web technologies but also had a knack for wasting the money they did spend. During the 1990s, productivity in health-care services declined, according to estimates from Economy.com Inc. That's a huge underachievement in a decade of strong gains for the overall economy.

All of that may be beginning to change. Hospitals such as Hackensack, along with insurers and the government, are stepping up their investments in technology. For hospitals, there's more motivation than ever: The government and private insurers are beginning to pay hospitals more for higher-quality care—and the only way to measure quality, and then improve it, is with more information technology. Hospital spending on such gear is expected to climb to \$30.5 billion next year, from \$25.8 billion in 2004, according to researcher Dorenfest Group.

Dollars are dandy. Even more important, though, hospitals finally seem to be figuring out how to make their tech investments pay off. Clumsy, sluggish first-generation systems have been tossed out. Hospitals are listening to doctors and nurses and installing laptops, software, and Net technologies fine-tuned to the rhythms of their work. The results are beginning to show up in national statistics: Economy.com figures that

health-care services productivity has risen about 2% annually since 2001, albeit at a slower pace than the overall economy.

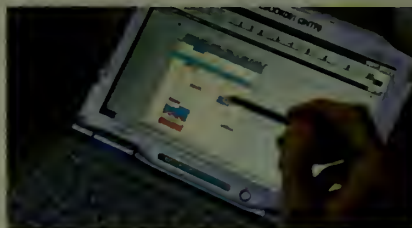
Such measurements in health care are more art than science. In other sectors, productivity is measured as output divided by hours worked. But health-care output is tough to measure. You can calculate how many worker hours it takes to deliver a one-day hospital stay. But there's no consensus on how to measure whether the quality of that care is better or worse than in the past. That's why the federal government punts, declining to release a productivity stat for health care. Economy.com measures production and worker hours without adjusting for quality of care. Other economists take issue with that calculation, even if it's just directionally correct, it means that after sluggish years, Hackensack and other institutions are delivering hospital stays, X-rays, and the like more efficiently.

Refining the **SOFTWARE**

IS THIS THE BEGINNING of a sea change or a false dawn? That question is being hotly debated. Skeptics abound. Most recently, a high-profile study published in the *Journal of the American Medical Association* in early March showed that a technology used by the University of Pennsylvania's hospital to prescribe drugs created new ways to make errors. Why? In one example, it scattered patient data and drug-ordering forms across so many different computer windows that it increased the likelihood of doctors ordering the wrong medications. "Hospitals need to make the systems work with the way medicine is

THE TECHNOLOGIES BEHIND THE CARE

In its quest to go digital, Hackensack University Medical Center is rolling out a host of new systems. Here's a sampling:



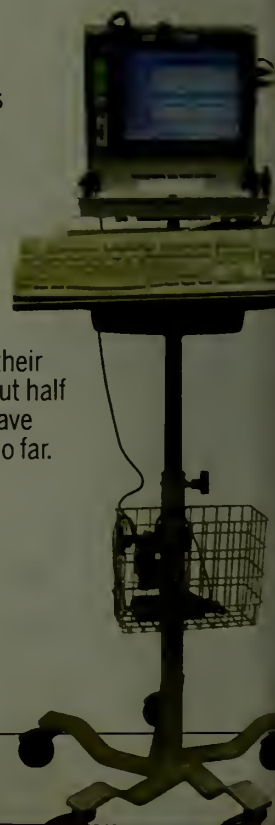
« **LIFEBOOK** Hackensack is testing this pocket-sized PC that hooks wirelessly into the hospital's network, giving doctors the freedom to place pharmacy orders and pull up medical records from anywhere in the hospital.



» **INSTANT X-RAYS** The hospital has set up an internal Web site that stores all of its medical images. This way doctors can view crystal-clear digital versions of their patients' X-rays, MRIs, and CT scans from any computer, in or out of the hospital.

» **E-CHARTS**

Nurses use these wireless mobile laptops to record patients' vital signs, symptoms, and medications. Doctors can sign in to the same central system from the laptops, too, or from any desktop PC to order prescriptions and lab tests and read their patients' progress. About half of the hospital's units have electronic prescribing so far.



" says Ross Koppel, the study's lead author and a professor at the University of Pennsylvania.

At the experiences of Hackensack and other hospitals nationwide suggest that health care really is making its way into the digital Age. Hackensack has successfully put in place an electronic prescription drug system. The New Jersey hospital, however, has spent long hours refining its software to eliminate some of the potential pitfalls cited in the University of Pennsylvania study. Such tech work has helped boost Hackensack's operating margins, to 3.1% last year from 1.2% in 2000.

The stakes couldn't be higher. Health care accounts for 15% of the U.S. economy, or \$1.7 trillion. It's so gargantuan that any efficiency gains make an impact on the overall economy. Dr. David Brailer, President George W. Bush's point man on health-innovation technology initiatives, predicts that tech investments will lead to \$140 billion a year in cost savings by 2014, or an estimated 6% of health-care spending in that year. "I actually think that's conservative," says Brailer. "There's a body of literature that shows case studies with much larger savings."

More important than saving money, of course, is saving lives. Health information kills some 7,000 Americans each year just by causing drug-interaction problems, according to the National Academy of Sciences Institute of Medicine. All together, hospital errors result in up to 98,000 deaths annually. Early evidence indicates that proper technology can reduce the toll. Hospitals that have begun using electronic prescription systems have seen up to 80% fewer prescription errors. And at Hackensack, patient mortality has dropped by 16% over the past four years, in part because of its digital initiatives.

More on the Digital Hospital at BusinessWeek.com

Bad hospital information systems often lead to medical errors: E-Business Editor and cancer survivor Tim Mullane on what happened to him—and how to protect yourself.

A slide show on the people—and the machines—that are turning Hackensack University Medical Center into a digital hospital.

Meet Mr. Rounder: This life-size robot allows doctors to visit patients electronically from anywhere.

A talk with David J. Brailer, President Bush's national coordinator for health-care technology, on the new age of e-health care.

BusinessWeek online

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While hospitals have always been devoted to saving lives, they're turning to tech now because of a fundamental change in U.S. health care. Pay for performance, that central tenet of Corporate America, is making its way into the world of health care. Medicare is leading the way. It set up a trial with 277 hospitals in which it's paying juicier fees for high-quality results in five treatment areas. "We're trying to create the business case for more coordinated, efficient care, and inevitably that means more investment in tech," says Dr. Mark McClellan, the head of Medicare.

It's quite a start. Medicare's trial suggests better information can lead to better care. The evidence? Since the 277 hospitals began gathering performance data and entering the spotlight of being publicly measured against their peers, the average quality-of-care scores have increased 6%. "This

gave hospitals a chance to see if public measurement and incentives would let them improve, and it has," says Stephanie Alexander, senior vice-president at Premier Inc., a research co-op of 1,500 hospitals that helps run the Medicare study.

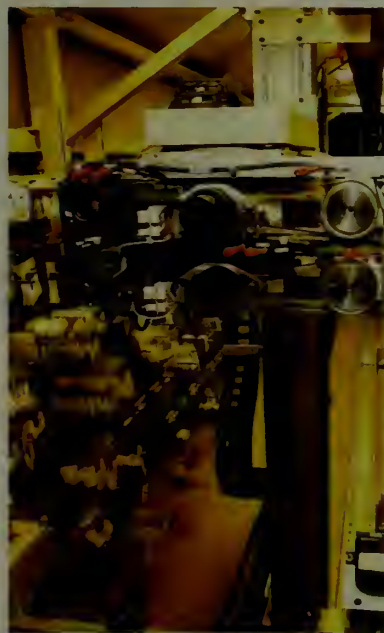
Private health insurers are moving toward pay-for-performance, too. Over the past two years, WellPoint Inc., UnitedHealth Group, and many other insurance companies have begun rating hospital treatments and rewarding high-quality care. Here's how it typically works: A hospital gets a fixed up-front fee for, say, a heart bypass. If the hospital scores high on quality for bypasses, it will get a bonus on top of that fee, usually 1% to 4%.

So why not jump in with both feet? Hospitals have financial constraints on their ability to purchase technology. There are competing demands. And while most hospitals can issue debt, they typically only do so for big-ticket items, such as a new building. For tech investments, hospitals pay for what they can out of cash flow. And cash isn't easy to come by these days. The nation's 5,760 hospitals have seen average profit margins fall for eight years, according to the American Hospital Assn.

Hackensack is a case study for the U.S. health-care system as it navigates these issues in the years ahead. It isn't a deep-pocketed academic hospital with the budget to do things few others can. It's a community hospital, nine miles from New York City, that symbolizes the challenges confronting local hospitals around the country. To get a firsthand look at this future, two *BusinessWeek* reporters went on rounds with doctors and nurses at Hackensack, sat in on staff

ROBOTIC PHARMACY

A giant robot named Robbie, equipped with arms, reads prescriptions entered into the hospital's computer system and then grabs medications stored on pegs on the wall. The pills are then dropped into containers that are marked for each patient.



ART TV Hackensack is rolling out 42-inch flat TVs in patient rooms. Patients will get more than just pay-per-view—they'll also be able to log on to the Web, take interactive classes about their condition, and find out how to take care of themselves after discharge.

meetings, and talked with patients about their experiences.

The most important piece of Hackensack's digital initiatives is the networked software that acts as the hospital's central nervous system. Nurses use wireless laptops on wheels to log in to this system to record patients' symptoms and get all the information they need to shuttle patients through their stay. Doctors tap into the network via wireless laptops or PCs to order prescriptions and lab tests. Everything else is linked into the system, from the automated pharmacy to the X-ray room, eliminating the need for most faxes, phone calls, and other administrative hassles.

Even Mr. Rounder is hooked in. As doctors use the robot to "visit" patients, they can zip off requests to refill drug orders or run lab tests from a separate window on their computer screens. The robot has proven its worth. When a blizzard stranded Dr. Garth Ballantyne at home, 82 miles from the hospital, he fired up Mr. Rounder. "I wouldn't have been able to drive here to see my patients that day," the surgeon says.

Still, the picture that emerged of Hackensack's experience is complex. The institution has poured \$72 million into IT projects since 1998, and the technology clearly is helping both productivity and quality of care. It's one of two hospitals in the Medicare pay-for-performance test group that has scored in the top 10% for four of the five categories Medicare is tracking—in heart failure, cardiac bypass, heart attack, and pneumonia. Yet Hackensack has a long way to go before it realizes the full potential of its digital initiatives. One sign of the distance to travel: Only 10% of tests and orders are entered electronically.

Hackensack offers clear lessons for other hospitals. Making technology pay takes time. It can be several years before the results of initiatives begin to surface. Just as important, making the technology work well takes a huge amount of effort. Hackensack's central software system is constantly being tweaked to ensure that it's woven into the routine of the medical staff.

Most important, doctors remain the key to hospitals' success. Wooing them is an extremely delicate task. Only 7% of doctors actually work for hospitals. The others are essentially independent operators who are not required to do what hospital administrators want. Many are wary of gadgets that take extra time or interfere with their work. But they aren't Luddites. Most are willing to experiment with new technology.

The key to winning them over? Hackensack and others must make sure the technology saves time, is easy to use right from the start, and doesn't get in the way of patient relationships. Over the past two years, Hackensack began the task of getting doctors to embrace the technology. It has made large strides.

The story of Hackensack is no simple parable. Doctors and nurses grouse about the new tech systems. Software fails; Web sites crash. The reality is that bringing technology into health care is messy. So don't take these notions on faith. Read on.

THE DOCTOR

Dr. Lauren KONIARIS

Online prescribing and record-keeping free her up for patients

IT'S A CHILLY FEBRUARY MORNING, AND DR. LAUREN KONIARIS is hustling down the hall at Hackensack. She stops in room 9001 and finds her first problem of the day: Patient Dawn Tribuzio, 62, complains that she has felt itchy ever since she started taking penicillin to treat a flare-up of sarcoidosis, a disease that causes inflammation of the lungs. Koniaris rushes to a computer in the corridor and pulls up Tribuzio's electronic record. It doesn't say she has a problem with penicillin, but it is her second reaction in recent weeks—a sign she may be developing an allergy. Koniaris clicks through a series of dropdown menus to cancel the antibiotic and order anti-itch cream. Then she makes a note of the allergy in Tribuzio's electronic record so the hospital won't prescribe the antibiotic to her again. "Now the pharmacy knows forever," Koniaris says.

At 4 feet, 11 inches, Koniaris may not stand out in a crowd, but she's a giant in Hackensack's battle to go digital. A geriatric specialist who's in private practice just a block from the hospital, she has entered more than 120 medication orders into Hackensack's central system since January, making her one of the top five users. Dr. Gerard A. Burns, who's responsible for persuading Hackensack's doctors to use technology, counts early adopters such as Koniaris to convince doctors still wary of their pens to start ordering drugs and lab tests on PCs.

Getting doctors to go digital is one of hospitals' most urgent goals. Unless physicians use the central system for prescriptions and records, they won't get instant warnings about dangerous drug interactions, and hospitals won't be able to collect data needed to improve care. Yet doctors have resisted attempts to get them to use digital devices. They have grumbled that the technology was clumsy or slow or put patients on hold.

What has made the difference at Hackensack is its ability to foster dialogue between doctors like Koniaris and techies.

HOW TECHNOLOGY IS TRANSFORMING YOUR HOSPITAL

Wiring hospitals will change the quality and business of health care by tracking patients and costs more efficiently. Here's what leading-edge hospitals like Hackensack University Medical Center are doing:

1 INVESTING IN TECHNOLOGY Health care was so slow to adopt Net technologies that output per worker in the sector fell in the 1990s. Now spending is beginning to rise. Take Hackensack: Since 1998 the New Jersey hospital has spent \$72 million to upgrade its tech infrastructure, automate its pharmacy, and roll out electronic medical records.

2 SELLING DOCS ON GOING Doctor resistance is a major obstacle to e-health. To get past this, Hackensack hired a trauma surgeon as its tech evangelist. He's making progress: the hospital's internal Web portal had 15,000 visits last year, up from 3,000 in 2001. Two major hurdles remain: Only 10% of tests and 10% of drugs are ordered electronically.



es. It's time-consuming, and the exchanges can be heated. They bear fruit. For example, when the e-prescription system was launched, Koniaris complained that the software made her slog through too many screens and enter information about patients that really wasn't necessary. "She'd send notes that said, 'This sucks. Fix it,'" says Burns. "And we Now the e-prescribing mirrors how doctors normally prescribe drugs—all it takes is a few clicks to order what they need.

Highway MONITORS

HER TIME, BURNS LENT Koniaris a pocket-size PC, hoping she would carry it on her rounds and enter orders right in the rooms. But she felt it hurt her bedside manner. "It took my focus away from patients when I have so little time with them already," she says. So Burns stopped pushing the desktop PCs. Instead, the hospital ensures there are enough PCs in the halls.

spend a day with Koniaris, and you quickly realize that her biggest problem is a shortage of time. A 38-year-old mother of three, she's a whirlwind of multitasking. So technology that can

QUALITY TIME Koniaris isn't as tied up in administrative chores as she used to be

they can use to second-guess doctors' decisions. Koniaris is well aware that Burns is getting together with other hospital staff to review medical records on his pocket-size notebook computer to try to determine which patients might be able to leave the hospital sooner than their doctors think they should. The Harvard-trained doctor doesn't appreciate the micromanagement. "They call me all the time and ask, 'Why is this patient still in the hospital?'" she says. "The pressure is intense."

Back at the hospital, Koniaris has discovered her second penicillin mixup of the day. Patient John Mahony, 83, is allergic, but the doctor who admitted him put him on it anyway. As Koniaris switches him to a different antibiotic and says goodbye, Mahony asks: "How long am I going to be in?" Koniaris makes no promises. Still, with technology on board to keep medication errors from befalling Mahony, he may be home sooner than he thinks. That's an outcome sure to make the hospital as happy as it makes the patient. »

save her time is a godsend. One reason she likes using PCs to order medicines is that she can see right away when she signs on what prescriptions need to be re-filled, instead of taking several minutes to page through paper records to get the information. She logs on to Hackensack's Web site to sign off on patients' records because it saves her from waiting for the hospital's snail-like elevator to take her to the medical records department.

For Koniaris, the minutes saved translate into more time to spend with patients. It's not a benefit that she measures in dollars. Nor do patients perceive a direct link between technology and the quality of care. But patients like Tribuzio do notice the small blessings of being treated by a doctor who isn't constantly tied up in an administrative muddle. "I call Dr. Koniaris, and she calls me back in 10 minutes," Tribuzio says.

Technology may save doctors time, but it also could cost them some control. Digitizing all these data means hospital administrators have access to information

FINALLY

USING DATA TO BOOST QUALITY

The real payoff is finding errors and improving care. Hackensack saved the time between when a patient is prescribed and when it reaches the patient. It also redesigned its care for heart failure and orthopedics patients, improving to the top 10% of hospitals treating those diseases in a program.

4 GETTING DEALS FROM INSURERS

Insurers are paying more for better care, since it leads to fewer repeat visits. Medicare is testing a program that pays an extra 2% per case to hospitals with treatment scores in the top 10% for illnesses such as pneumonia, heart attacks, or hip replacements. Since Medicare pays for about 30% of U.S. hospital care, that's enough to double profits at some hospitals.

5 USING QUALITY TO LURE CUSTOMERS AND BUY MORE TECH

Insurers and big employers are trying to push consumers to tech-savvy, high-quality hospitals. How? They reduce co-payments if patients use preferred providers and post care-quality info on insurers' sites. Horizon Blue Cross is pushing cardiac patients to Hackensack because of the improvements it has made using tech.

THE NURSE

Melanie WEIGESHOFF

Why the "laptop-on-a-stick" is a hard-pressed R.N.'s best friend

WHEN MELANIE WEIGESHOFF joined Hackensack in 1998 as a nursing assistant, the hospital was still in the dark ages. Most medication orders, lab test results, and doctors' instructions for patient care were recorded on paper, in giant three-ring binders. Weigeshoff was constantly on the phone clarifying doctors' quickly scribbled notes, and she spent hours chronicling her patients' progress by hand. "We were always flipping, flipping, flipping through pages," she recalls, reenacting the frustration with frantic waves of her arms.

Today that primitive hospital is just a memory for Weigeshoff, 26, now a staff nurse. Although she still uses paper on occasion, her primary tool since 2003 has been a laptop-on-a-stick, a PC that roils around on what looks like an IV stand. As she greets patients at the start of each shift, she logs in to their electronic records through a wireless connection. She reviews vital signs—temperature, heart rate—which had been tapped into the computer by a nurse's aide earlier. Then she clicks over to the medication orders, making a note of each dose on the computer after she delivers it. "Charting is more accurate now," she says, "because we're right there, doing everything in real time." Best of all, she has shaved an hour of overtime off her day.

As the hospital industry grapples with an unrelenting nursing shortage, technology has taken a leading role in keeping employees like Weigeshoff happy. Many of the demands of managed care have been heaped onto nurses, burdening them with more patients to care for in less time and an endless flood of paperwork. The pressures have driven so many out of the profession that the supply of nurses is expected to fall 20% below the demand by 2010. Surveys reveal that one out of every three nurses under 30 plans to leave the job within a year. Technology that makes nurses' jobs easier won't be a panacea, but "it's an important consideration in



BEDSIDE DATA From a hospital room, Weigeshoff can record—or retrieve—information instantly

making the hospital a better work environment," says C. Bickford, senior policy fellow at the American Nurses Association.

Technology is lightening Weigeshoff's administrative load in all kinds of ways. As she prepares to visit patient Williams, she grabs the laptop and wheels it into his room. That day, a roboticized sorting machine in the pharmacy downstairs had read Alves's prescriptions on his electronic chart and sent them to Weigeshoff's unit. As she checks a prescription on the screen, Williams calls out the names of drugs in her basket to make sure Weigeshoff has everything. Gesturing toward the laptop as if it were another person to help him feel better, "Protonix?" asks the 60-year-old, recovering from pneumonia. "Yep," says Weigeshoff. In the past, she would have had to collect handwritten prescriptions, enter them into paper charts, and fax them to the pharmacy.

For Weigeshoff, the laptop-on-a-stick frees her to be the nurse she dreamed about being when she was a little girl growing up in northern New Jersey. As a teen, she relished the role of the big sister, coddling her toddler brother and sister who needed a Band-Aid on a scraped knee or a kiss on a bruised head. "I love taking care of people," says the ebullient nurse.

Information CENTRAL

BUT WHEN SHE FIRST STARTED in nursing, she often struggled to find time for the caregiving part of her job. She was always on the phone with the pharmacy, pressing them for medication refills, or with doctors, trying to decipher handwriting. No system ensures that the pharmacy gets drugs to nurses on time, and that almost every piece of information she needs is

at her fingertips, from what insulin plan her patients are on to the tests they've had in the hospital.

Weaning the nurses off traditional paper charts isn't as easy, though. "On the first day you go live on a unit, everyone says, 'I'm going to kill me,'" says Teresa C. Moore, the hospital's manager of clinical informatics. She oversees the rollout of the technology in nursing units, with about 10 units equipped with wireless computers so far. "It's a drastic change," she says.

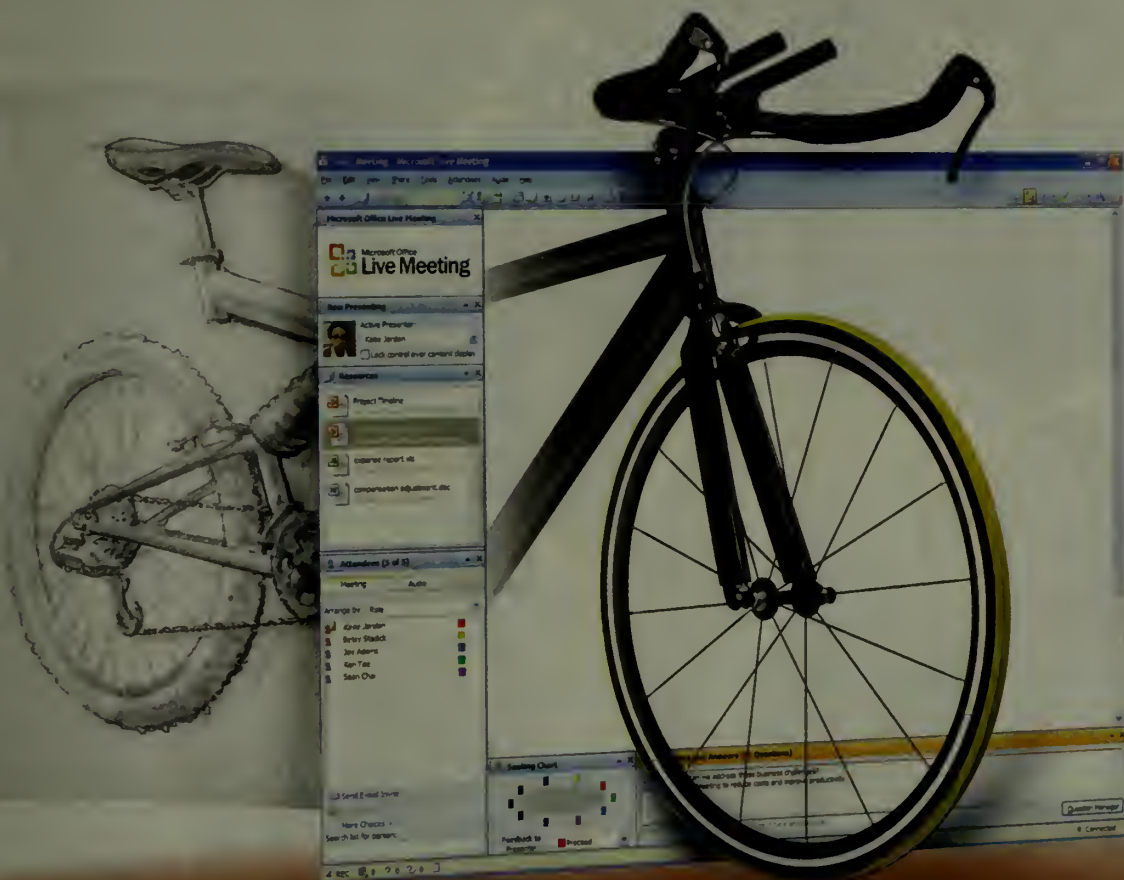
Unlike most of the doctors at Hackensack, the nurses are hospital employees and are required to use technology in their work. Moore runs weekly user groups to gather feedback. The first

time the system went online, for example, nurses complained the diabetes-treatment insulin was listed on the computer as regularly scheduled medication. But nurses have to adjust insulin dosing based on patients' blood-sugar levels—a problem they struggled to record because the hospital deployed the software incorrectly. The nurses protested so loudly that Moore's team worked five days straight to fix the problem.

Weigeshoff welcomes any technology that will make her job easier. Paper charts won't go away anytime soon—the hospital still requires printed copies of everything entered in the computer, and some notes can't be made digitally yet. "I would love to never have to write again," she says. A dream? Maybe. At Hackensack, it's getting closer to reality. »

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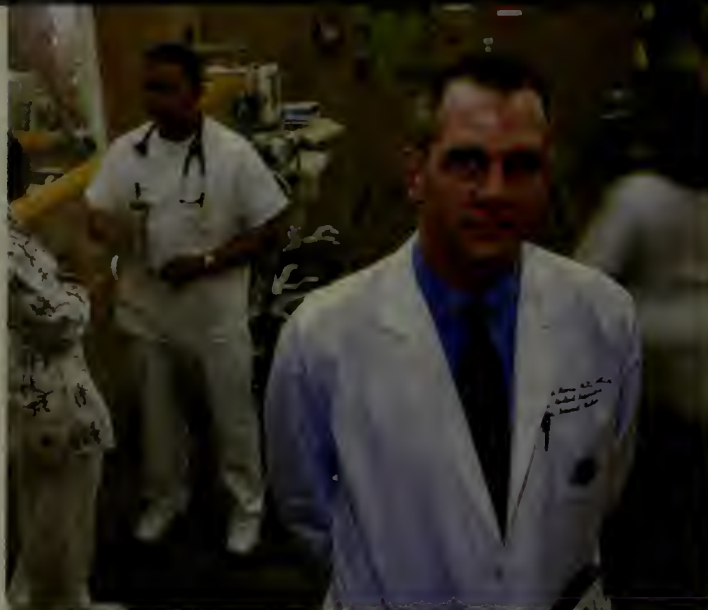
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THE TECH GURU

Dr. Gerard **BURNS**

A former trauma surgeon
champions life-saving data

SIX YEARS AGO, GERARD A. BURNS WAS AS tech-phobic as any doctor. A trauma surgeon at Yale School of Medicine, he had his secretaries read him his e-mails while he was scrubbing up for surgery. So how did the 44-year-old become a key player in turning Hackensack into a leading e-hospital? He got bored. In 1999 he left for business school and ended up landing a job at a medical software company. When Hackensack in 2002 was looking for someone to get its 1,285 docs to adopt digital medicine, Burns jumped at the chance.

Hiring an M.D. for the job may have been one of Hackensack's canniest decisions. Burns's degree gives him instant credibility with the physicians as he prods them to use the hospital's fast-evolving tech systems. "You have to be part diplomat and part hard-ass," says Burns.

Working from a windowless office in Hackensack's tech department, Burns has three or four basic jobs. He evangelizes technology to doctors. He personally reviews the electronic orders doctors place and coaches those who don't get it quite right. And he translates complaints from doctors about hard-to-use technology for the tech group so it can fix them.

The most important part of his job, though, is marshaling data to help the administration improve care. This practice, called informatics, is a touchy business because it typically involves midlevel administrators gathering stats and then trying

WATCHMAN Dr. Burns's data allows the hospital to look more closely over physicians' shoulders

to use them to get doctors to change their habits. At most, the bean counters get back to their cubicles, then chastened. Besides being

Burns, whose title is director of medical informatics, has the advantage of being on Hackensack's medical board, the hospital's top medical policymaking body. "He probably has more influence than anyone at the hospital because he works with department chair," says Chief Medical Officer Dr. Peter Mauro. "They know he has my support."

Slicing, **DICING**

FOLLOW BURNS AROUND, and you see how fast plans are being made. He holds tech briefings for doctors and sits in on sessions held to review patient cases. One of his duties these days is going to pore over the data from Hackensack's procedures, orthopedics, medication management, and pneumonia. This is being prompted in part by the Medicare pilot program to test hospitals' quality of care and then pay more for better care. Medicare data highlight things Hackensack may do slowly, such as not giving pneumonia patients flu shots or being more than vigilant about documenting infection control in operating rooms. Burns slices and dices the stats and then tries to help doctors and administrators find ways to tighten up.

Collecting data lets Hackensack look much more closely at doctors' shoulders—something they don't always like. Take the MDR program: rolling out a procedure called multidisciplinary rounds, or MDRs. These rounds are daily reviews of each patient in a nursing unit, conducted by nurses, case managers, social workers, and an in-hospital doctor. In some units, team members use Lifebooks, which are wireless laptop PCs, to pull up patient vital signs, doctors' notes, and lab tests from the hospital's electronic system. They can prescribe drugs or even recommend a patient be discharged, a dramatic step since doctors traditionally made such decisions. The hospital raised the ante this winter with a policy that temporarily suspends doctors from handling cases if they repeatedly ignore the MDR team's recommendations.

That sparked one of the few signs of rebellion at a hospital where the administration has moved gingerly to avoid spooking doctors. "People are irate over this," says Judith C. Gellera, a kidney specialist, during one early-morning MDR meeting. "The meddling is producing results. Since 2001, floors using Lifebooks in MDRs have slashed the average length of patient stays by 24%. And readmissions for the MDR floors, a gauge of whether patients are being sent home safely, dropped 12% between 2002 and 2003." "MDRs are probably the biggest contributor to the improvements in quality that we've made," Burns tells the group.

Crunching data instead of patching holes may seem like a sharp turn. But as hospitals get wired, they're showing that cold data can help patients as much as surgical heroics. "Don't you miss being part of a team that saves lives?" I say, "I still do [save lives], but in a different way," Burns says.

That is the hope of health-care organizations across America. They're stepping up tech spending, betting that it will provide an antidote to spiraling costs, while improving care. Thousands of lives and billions of dollars are at stake. Hackensack is just a part of the future taking shape, one digital hospital at a time. ■

“ You have to be part diplomat and part hard-ass” to prod doctors to adopt digital medicine

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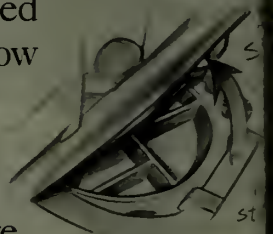


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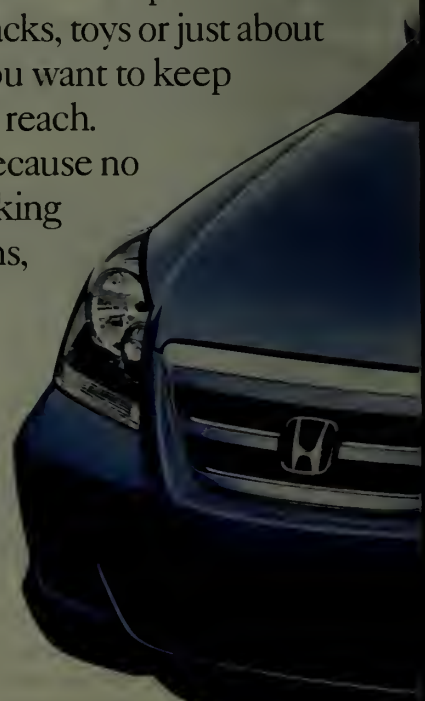
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Meet the Best And Brightest

Forty gifted U.S. high school science students told us what matters to them

BACK IN THE 1980S, WITH the auto and electronics industries under assault from Japan, U.S. executives loudly bemoaned America's relatively poor skills in math, science, and engineering. The lament has never stopped. Despite the calls for action spanning decades, "we still do a very, very poor job of educating our kids" in science and math, says Craig R. Barrett, CEO of Intel Corp. Compare high school graduates in the world's top 25 countries, he says, and "an American kid is, on average, near the bottom 10%."

No quick fix will turn this situation around. But to regain a glimmer of optimism, there's nothing like a close encounter with some of America's brightest students in science and math. With Intel's consent, *BusinessWeek* solicited the thoughts and aspirations of the 40 finalists in the Intel Science Talent Search (STS, which was sponsored by Westinghouse before 1998). Arguably the most prestigious competition for technically inclined U.S. high school seniors, STS guarantees \$5,000 college scholarships to the

40 who make it to the final round. The top three prizes are worth \$100,000, \$75,000, and \$50,000. Past STS winners have gone on to notch six Nobel prizes, three Medal of Science awards, and 10 MacArthur Foundation "genius grants."

A sample of 40 exceptional students—10 of whom got perfect scores on their SATs—can't capture the talents or attitudes of all 1,600 students who entered the competition. It's an even blurrier reflection of all the high schoolers around the country who seriously pursue science. But the sample does show what's possible when gifted kids are nurtured by caring parents, challenged by high expectations in school, encouraged to explore what interests them, and given a chance to work with mentors at universities and U.S. national laboratories. And by surveying the finalists, *BusinessWeek* was able to glimpse how top-performing students would shape government science policies if they were handed the opportunity.

The projects that won recognition for the STS finalists, aged 16 to 18, cover a remarkable swath, from archeological fieldwork to the social sciences. Albert Tsao from Silver Spring, Md., developed a potential fiber-optic transistor for superfast optical computers. Aaron S. Goldin in Encinitas, Calif., created a prototype wave-powered generator. And Kelley Harris from Sacramento studied molecular interactions that could lead to new strategies against smallpox—her project won third place.

Two students worked with the atom smashers at Brookhaven National Laboratory and Fermi National Accelerator Lab-

SMART COOKIES

Some of the finalists in the Intel Science Talent Search. Back row, from left: Ling Pan, Albert Tsao, James Cahill, Aaron Goldin, and Karl Plank. Front row: Neal Wadhwa, Ryan Harrison, grand-prize winner David Bauer, Sarah Langberg, and Po-Ling Loh

oratory: Shan Yuan "Ben" Huan Coram, N.Y., and Timothy F. Credo Highland Park, Ill. Credo's software new particle detector at Fermi earned the No. 2 award. And the prize went to David L.V. Bauer of York City. He developed a sensor, including a nanoscale component, designed to detect exposure to all the main neurotoxins that America's foes might likely to deploy.

While the students' accomplishments are cause for celebration, there's a question the U.S. is at a crossroads facing a challenge more threatening than Japan's industrial onslaught i-

The Intel Award Winners, Up Close

Over the next several days, *BusinessWeek* Online will be posting additional material about the students and their projects:

Meet the winners: a complete list of the 40 finalists and their schools

Explore the projects: close-ups of the research that excited the panel of judges

What the students think: essays by the high schoolers and the opinion poll

BusinessWeek online

<http://www.businessweek.com/go/sts>



s. When that threat emerged, the marshaled its resources, matched in quality, called up its reserves of ingenuity, and stemmed losses in net share.

PRESSURE'S ON

TIME AROUND, as competitive pressure mounts from China, India, and other emerging economies, America's greatest vulnerability is internal. It's the education the U.S. depends on to educate its children. Unless this vulnerability is addressed, declares a chorus of prominent scientists, educators, and business leaders, the nation's hopes for sustained

prosperity could be dashed. Without a technically skilled workforce, U.S. business "won't be able to compete globally," says John Engler, president of the National Association of Manufacturers.

Some of the data on this topic keep getting gloomier. Last December's report from the Organization for Economic Cooperation & Development's Program for International Student Assessment (PISA), for example, ranked the math skills of U.S. 15-year-olds 24th among the 29 OECD countries. Just three years ago, PISA put the U.S. at No. 18.

Such test scores don't tell the whole story, though. Ask students born in Asia what

they've gained from a U.S. education, and the answer is unanimous: creative thinking skills. U.S. schools—good ones, anyway—expand the ways kids think about problems. And that, they agree, is the secret of U.S. invention and innovation.

Company execs contemplating recruitment can only wish for more students like the STS winners and finalists. In the past, business has counted on an influx of foreign talent to compensate for shortfalls. "But I don't think we can continue to rely on that," says Joseph A. Miller, chief technology officer at Corning Inc. "The competition for talent has increased substantially worldwide," he explains. "To

continue to innovate as a nation, we need to ensure that we'll have a domestic source of people well prepared in science, engineering, and math."

Education also tops the list of the *Innovation Policy Agenda*, presented earlier this month to Washington officials by TechNet, a bipartisan club of 150 top executives in the high-tech sector. TechNet convened a series of summits around the country last year and came to a grim conclusion: The U.S. has been chiseling away at its competitiveness for so long that it could soon crumble. "Just because we led before doesn't mean we'll lead in the future," warns John T. Chambers, CEO of Cisco Systems Inc. and co-founder of TechNet.

Largely, that's because the U.S. isn't planting enough new seeds of invention and innovation. "After education, our No. 2 problem is spending on basic research," declares Intel's Barrett. As a percentage of gross domestic product, federal support of basic research in the physical sciences has actually declined by more than one-third over the past 25 years. Now the Bush Administration wants to cut the National Science Foundation's budget by 10%. Instead, says Barrett, the NSF's budget ought to double over the next five years, just as the National Institutes of Health's budget has doubled over the past five years.

LESS BANG, MORE BUCKS

THE STS FINALISTS for the most part agree that Washington should support more research. This was one issue raised in both the opinion survey (opposite) and roundtable discussions *BusinessWeek* conducted with the finalists in Washington just before the winners were announced. More federal money for research on alternative energy was the

FIRST PLACE

David L.V. Bauer



AGE 17
Hunter College
High School,
New York City

AMBITION:
Chemistry professor

PROJECT
(Mathematics)
Biology: Devel-

oped a nano-scale biosensor for detecting neurotoxins. His system is designed to quickly identify the presence of all major nerve gases and agents.

students' chief priority, followed by medicine and health care, the environment, and biotechnology.

Asked how they would pay for the additional research, the two top recommendations were to shift money from the Defense Dept. (after the U.S. pulls out of Iraq and Afghanistan) and raise taxes on the wealthy, on energy companies, and on big polluters. Next came trimming Social Security and welfare benefits.

All 40 students are either "very much" or "somewhat" in favor of developing alternative energy sources—the only issue on the poll without a single dissenter. "But this doesn't seem to be a very big issue for the politicians right now," notes Bruce X. Brewington of Fairport, N.Y. That's probably due to a lack of public pressure, says Stephen J. DeVience of Chicago. "People seem to complacently believe that engineers will find solutions in time to avert a crisis."

U.S. energy policy is too focused on traditional fossil fuels, assert several students. "These policies paralyze us from taking the lead in alternative energy solutions," says Aaron Goldin. Ailish E. Bateman in Sag Harbor, N.Y., agrees. "Striving to maintain yesterday's status quo," she says, "just tilts world politics more steeply. Even rumors of an oil cut-back send stocks tumbling." Ian R. Haken of Plano, Tex., thinks the government should start making changes now, "even if they go against the public will." Personally, he adds, "I'm in favor of electric cars that would be charged with electricity produced by nuclear power."

Nuclear energy was a divisive topic at the roundtables. Several students fear another accident like the 1986 explosion at Chernobyl in Ukraine. They also cite the problem of radioactive waste. Among

those on the other side, Robert T. well from Albuquerque pointed out burning coal "actually produces radioactive waste—and spreads it a more," whereas nuclear fuel can be cled. None of the skeptics was persuaded although Amber I. Hess of Carmel, said more of such statistics would be "really useful" for an informed debate.

On the education front, the STS students have many ideas for improvement. Several feel that Americans' disinclination to plunge into science and technology traces back to early childhood. "The motivation to learn can be inspired in elementary school," says Michael Forbes from Silver Spring. Starting earlier would be better, says top-winner Bauer. "Studies have shown that patterns for learning are set by the age of four," he notes. "This means we need to provide preschool, not day care, for three- and four-year-olds."

Another recommendation is to introduce youngsters to tougher challenges earlier in life, as do some countries that perform better on international assessments like PISA. Michael J. Barany of Falcon Heights, Minn., points to textbooks in Singapore. "Their students are routinely asked to do stu-

AGENDA

Opinion Poll

BusinessWeek asked the 40 finalists in the Intel Science Talent Search to express their opinions on a variety of futuristic issues in science, business, and government. Among the patterns that emerged: More than half of the students are deeply troubled by global poverty, the proliferation of nuclear weapons, and the potential negative impact of Bush Administration policies on science and the environment. Three-quarters of the finalists strongly support stem-cell research (only one doesn't support it at all). And all but three expressed very strong support for the development of alternative energy sources. Here are the salient results:

SECOND PLACE

Timothy F. Credo



AGE 17
Illinois
Mathematics &
Science Academy,
Aurora, Ill.

AMBITION:
University professor

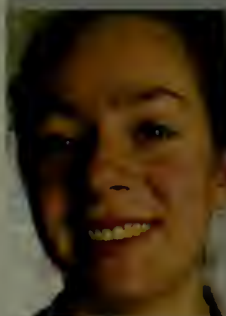
PROJECT
(Physics)
Wrote the software

for, and helped develop, a fast, accurate detector for subatomic particles at Fermi National Accelerator Laboratory.

...t encounter until the seventh grade, ...m ahead of the American curve." ...t what really troubles these students ... standardized testing used increas- ... to measure school performance. ... ers spend way too much time "get- ... tudents to do well on these tests," ... Tsao. The result is a dumbing-down ... leemphasizes learning and explo- ... in favor of focused training for tak- ... he tests. It's a huge turn-off for ... -average kids, say these students. ... ed to comment on the issue of ... n in science—a contentious topic in ... ke of remarks by Harvard Univer- ... President Lawrence H. Summers ... gender disparities—some finalists ... that middle school is the pivotal ... for females. Studies show that in el- ... tary school, girls are at least as in- ... ed in, and as good at, science and ... as are boys. But social conditioning, ... ially by teachers and peers, during ... rly teenage years changes that, says ... ng Loh from Madison, Wis. Girls ... d be encouraged to ignore chiding ... math and science being "too ... " for a girl, she says. Summers ... to take another look at gender dif- ... es, suggests Ling Pan of New York ... More women scientists would en-

THIRD PLACE

Kelley Harris



AGE 17
C.K. McClatchy
High School,
Sacramento

AMBITION:
Biophysics
professor

PROJECT
(black-emlery):
Identified molecular

interactions between so-called Z-form DNA and relatively unknown proteins that bind to it. She hopes the work might lead to new strategies against smallpox.

hance competitiveness, she asserts, be- cause there is evidence that "women are better at multitasking and making con- nections across disciplines, while men are better at focusing on one discipline."

Some of the schools represented at the Intel event have amazing success records in repeatedly sending students to STS and similar competitions. For example, five STS finalists this year hail from Mont-

gomery Blair High School in Silver Spring, Md. Noting that fact, students suggested that there are concrete steps leading to successful programs in science, and that these steps could be implement- ed more broadly in different schools.

After all, most children aren't math wizards, any more than they're musical prodigies. But that doesn't mean mediocre performance is destiny. Schools need to foster more interest in science in the lower grades. And middle- school teachers should toss tougher challenges at girls, in particular. Greater emphasis should also be placed on men- tors, the students say, with colleges ex- panding outreach programs; and high schools with no nearby university could form volunteer mentoring clubs staffed with their best students and parents.

Ultimately, America's educational sys- tem needs to pay as much attention to bright students as it does to slow learn- ers. That would give more U.S. kids a bet- ter chance to stand tall in international comparisons. And it just might help counteract the scientific illiteracy that threatens to drag down the performance of American businesses. ■

—By Otis Port, with John Carey, in Washington

r Worries...

TURBED ARE YOU BY:	VERY MUCH	SOMEWHAT	NOT AT ALL
Technology's erosion of privacy	9	26	4
Power among corporate executives	14	22	4
Excess business practices	15	22	3
Excess globalization	3	18	19
Expenditure of money on politics	22	16	1
Administration policies in general	19	15	2
Negative effects on science	27	9	3
Negative effects on the environment	24	11	4
Decision on stem-cell research	26	12	2
Cost of U.S. health care	17	15	7
Unemployment in Africa and the tropics	20	17	3
World population growth	11	19	10
Unemployment—domestic	15	21	4
Unemployment—worldwide	25	12	3
Global warming	8	26	5
Environmental degradation	18	20	2
Grades of U.S. schools	22	15	3
Chemical terrorism	9	22	8
Structure attacks via the Net	7	25	8
Shrinkage of U.S. manufacturing base	5	25	10
Lack of progress of alternative energy	24	12	4

...And Their Priorities

HOW SUPPORTIVE ARE YOU OF:	VERY MUCH	SOMEWHAT	NOT AT ALL
Cloning animals	15	18	5
Cloning humans	4	17	17
Genetically modified foods/plants	16	20	3
Stem-cell research	30	8	1
Developing alternative energy sources	37	3	0
Environmental protection	28	9	2
Sustainable development	27	10	2
Space colonies on the moon and Mars	10	21	9
Space travel to other solar systems	14	19	7
Space tourism (SpaceShipOne)	14	15	11
More federal R&D funding for:			
Alternative energy sources	32	6	2
Biotechnology	26	9	5
Computer science and engineering	19	18	3
Environmental protection	27	9	4
Manufacturing science	16	16	8
Mathematics	15	21	4
Medicine and health care	30	9	1
Nanotechnology	21	16	3
Physics and chemistry	23	14	3
Sustainable development	21	16	1

Responses don't total 40 on all lines, indicating that one or more finalists had no opinion.

**“INNOVATIVE THINKING?
WE DON'T EVEN HAVE TIME
FOR BAD THINKING.”**



Innovation. You tell yourself it's a top priority, but between e-mail, meetings and fending off the crisis du jour, you never get to it. How do you break the cycle? You get help. Two kinds of help. First, help with those tangled business processes – identifying and fixing what has you running in circles, what doesn't work, what distracts you (and costs you) every day. Tackle those issues and you'll uncover a leaner, nimbler, more flexible you. You'll be innovating on demand.

“YEAH, BUT TRY GETTING THAT IDEA THROUGH THE SYSTEM.”

Need a pitch? Try this. Nothing delivers more value to a business than innovation. Nothing. Smooth the path to innovation and your whole company wins. Which brings us to the second kind of help: IBM On Demand Innovation Services. Perhaps you have the idea but lack the resources to make it happen? Perhaps the solution doesn't exist yet? We can help. **“HOW WOULD I EVEN START?”**

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And it's not just pie in the sky, either. Thousands of companies have already trusted IBM's experience and depth of expertise to make it happen. Intrigued? Skip a meeting or two. Give innovation some thought. Or for ideas, visit ibm.com/ondemand/innovation

ON DEMAND BUSINESS™

Why Logic Often Takes a Backseat

The study of neuroeconomics may topple the notion of rational decision-making

THE NATIONAL HOCKEY League and its players wrangle over a salary cap. The impasse causes the season to be canceled. Everybody loses. What went wrong?

According to the new science of neuroeconomics, the explanation might lie inside the brains of the negotiators. Not in the prefrontal cortex, where people rationally weigh pros and cons, but deep inside, where powerful emotions arise. Brain scans show that when people feel they're being treated unfairly, a small area called the anterior insula lights up, engendering the same disgust that people get from, say, smelling a skunk. That overwhelms the deliberations of the prefrontal cortex. With primitive brain functions so powerful, it's no wonder that economic transactions often go awry. "In some ways, modern economic life for humans is like a monkey driving a car," says Colin F. Camerer, an economist at California Institute of Technology.

Until recently, economists contented themselves with observing people from the outside. Now, Camerer and others, teaming up with psychologists and neuroscientists, are using a technique called functional magnetic resonance imaging to look inside the skull. It's like watching Congress debate instead of inferring what's going on by reading the laws that get passed.

Neuroeconomics, while still regarded skeptically by mainstream economists, could be the next big thing in the field. It promises to put economics on a firmer

footing by describing people as they really are, not as some oversimplified mathematical model would have them be. Eventually it could help economists design incentives that gently guide people toward making decisions that are in their long-term best interests in everything from labor negotiations to diets to 401(k) plans. Says Harvard University economist David I. Laibson, another leading researcher: "To understand the real foundations of our behavior and our choices, we need to get inside the black box."

A GRAB BAG OF ANOMALIES?

NEUROECONOMICS COULD also give economics an alternative theoretical framework. Since the early 1900s, economists have mainly assumed that people have a stable and consistent set of preferences that they try to satisfy. When faced with an apparently illogical outcome—such as the cancellation of the hockey season—they try to explain it as the result of a reasoned decision process. Such top economists as Gary S. Becker, Milton Friedman, and Robert E. Lucas Jr., all Nobel prize winners, have argued that discrimination, unemployment, and stock market gyrations can have rational origins.

In recent years, the assumption of rationality has taken some hard shots as economists have shown that people often lack self-control, are shortsighted, and overreact to the fear of losses. But to date, these attacks on rationality—under the broad heading of "behavioral economics"—have seemed more like a grab

bag of anomalies than a consistent native theory. So the assumption of rationality survives.

By linking economic behavior to brain activity, however, neuroeconomics may finally supply the model that knocks mainstream economics off its throne. The theory should fit better with reality, won't be as mathematically clear, and because the brain is a confusing place with different parts handling different tasks. Says Camerer: "You are forced to think about a brain which has many somewhat modular circuits."

One of the most fruitful avenues of neuro research is "time inconsistency." When people decide about the distant future, they're roughly as rational as economic textbooks assume. But when faced with a choice of whether to consume something now or delay gratification, they can be as impulsive as children. Harvard's Laibson coined "quasi-hyperbolic discounting" to describe this behavior, but that was just a label, not an explanation.

So Laibson and others scanned brains inside MRI machines and discovered different parts of the brain operating in radically different ways. For decisions about the far-off future, the prefrontal cortex takes the long-term perspective. But for decisions such as whether to buy another chocolate bar right now, the limbic system takes over and demands immediate gratification. Last year the journal *Science* published the research by Laibson, Princeton University neuroscientists Samuel McClure and Jonathan D. Cohen, and Carnegie-Mellon University economist George Loewenstein.

How does it help to know that you have literally "of two minds"? You can arrange your affairs to make sure your rational brain stays in control. For example, by committing now to save a certain percentage of your pay each month in the future. Many people already do that. Trouble is, long-term commitments can be too rigid if circumstances change. Ideally, you'd like to be able to commit to a savings plan until you can't afford it—but not so long that your animal brain takes over and you lose the will to save. The new research could help get that balance.

A key tenet of standard economics is that making people happy is a simpler matter of giving them more of what they want. But neuroscience shows that's not true. The brain's striatum quickly gets used to new stimuli and expects them to continue. People are on a treadmill in which only unexpected pleasures can make them happy.

Economists use MRIs to glimpse the way we make certain choices

side the **Black** Box

Research lets economists
offer different kinds of behavior
in particular areas of the
—and gives them a new
for designing incentives
to steer people to make
choices

PEOPLE CAN BE

BIGHTED People use
rational **prefrontal cortex**
for decisions. But the
effect of immediate rewards
and punishments activates the
entire **limbic system** of the
brain, often leading to
poor choices.

PEOPLE CHANGE BEHAVIOR

TRULY The **anterior cingulate**
acts as “advice” from the rational
prefrontal cortex and the **limbic**
system, then picks which to follow.
A change in conditions
can cause it to tip from one choice
to another.

PEOPLE LOVE BONUSES

The **striatum** of the animal brain
gets used to new stimuli
and reacts only to the unexpected,
like a financial windfall.

PEOPLE PUNISH CHEATERS

The **anterior insula** reacts strongly
to perceived unfairness, which
causes people to punish unfair behavior. But the
entire part of the brain may trigger
actions such as road rage.

MONEY IS ITS OWN REWARD

The **nucleus accumbens** responds
in the same way it reacts to
cocaine. In other words,
money is valued for itself and not
just for what it can buy.

It explains why happiness of people
in rich countries hasn't increased despite
rising living standards.
Neuroeconomics also challenges the
idea that emotions can only corrupt
rational decision-making. Indeed, emo-
tions grab people's attention and moti-
vate them to focus their rational brains on
the issue at hand, says Antonio R. Dama-
sio, a neurologist at the University of Iowa College of Medi-
cine who studies brain-damaged
patients. In his writings, he says that
people who feel no emotions are bad at
making decisions.

The most controversial aspect of neu-
roeconomics is what to do with its find-
ings. Cornell University economist
Robert H. Frank favors taxation of con-
spicuous consumption, arguing that
flashy spending simply raises expecta-
tions, making the rich no happier and
squeezing the middle class. Laibson, in
contrast, isn't willing to go much further
than using neuroeconomics to, say, im-
prove the default choices in 401(k)s.

Neuroeconomics has its skeptics.
Richard Thaler of the University of
Chicago, a leading behavioral economist,

argues that it has yet to produce a major,
surprising finding. He says he prefers to
leave brain research to the neuroscien-
tists. But he adds: “I am a big believer in
letting all flowers bloom.”

Even believers in neuroeconomics
aren't sure just how far to take it. Should
economic policy satisfy the farsighted
prefrontal cortex? Or should it sometimes
indulge the impulsive limbic system? By
peering into the brain, economists are
making discoveries that will keep them
arguing for years to come. ■

—By Peter Coy in New York



PHOTOGRAPH BY GARRY WADE/GETTY IMAGES; ILLUSTRATION BY LAUREL DAUNIS-ALLEN/BW

DIMON'S GRAND DESIGN

Jamie Dimon is bracing for another tough year at JPMorgan. But now he has a \$1.1 billion plan to revive the nation's No. 2 bank. An inside look.

BY MARA DER HOVANESIAN

ONE RECENT WINTER night, JPMorgan Chase & Co. pulled out the stops for a lavish bash at New York's American Museum of Natural History. Among the 200 or so guests were such luminaries as Senator Hillary Rodham Clinton (D-N.Y.) and Apple Computer Inc. CEO Steven P. Jobs. It was as much a celebration of the bank as it was a fundraiser for the Global Fund for Women. After years of consolidation, JPMorgan has amassed more than \$1 trillion in assets, only the second U.S. bank ever to get so big. From the podium, Walter V. Shipley, 70, the long-retired chairman of Chase Manhattan Corp., asked rhetorically: "Who here even remembers what the market cap of Manufacturers Hanover was when it merged with Chemical Bank"—the deal that set the ball rolling toward the creation of JPMorgan Chase 15 years later.

At the head table, banking brainiac Jamie Dimon blurt-

ed out the answer: \$1.9 billion. It was classic Dimon. JPMorgan's president and chief operating officer is often first to the punch, knows his numbers cold, and is unabashed about making that loud and clear. He also has an uncanny knack of inadvertently upstaging the main event. Dimon spent more than 15 years at Citigroup and its predecessors as right hand to Sanford "Sandy" I. Weill and three years as CEO of Chicago's once-troubled Bank One Corp. The 49-year-old Dimon's obsession with detail and disdain for waste made him a corporate legend. General Electric Co. had Neutron Jack Welch. JPMorgan has its Hatchet Man.

In the year since the \$58.5 billion sale of Bank One to JPMorgan, the boy from Queens and CEO-in-waiting has gone about doing what he does best. By yearend, most of the 12,000 jobs to be cut—about 7% of the workforce—will be gone. A \$5 billion outsourcing contract with IBM and executive perks such as country club memberships and first-class travel are already

THE STAT

**\$3
billion**

Dimon's target for annual cost savings by 2007

Data: J.P. Morgan Chase



history. Yet melding the two banks—each with a legacy of half-digested mergers and chaotic back-office systems—is turning out to be trickier than expected. Since finalizing its merger last July 1, the bank has had two back-to-back quarters of weak earnings, caused by poor trading results, escalating merger costs, and rising wages, mostly in the investment bank.

‘TONS OF IDEAS’

WHAT’S MORE, THE immediate outlook looks grim. *BusinessWeek* has learned that this year’s earnings will be much worse than the \$3.06 per share Wall Street now expects after cutting its estimates by 21¢ in January. Part of the reason is rising legal costs: On Mar. 16, JPMorgan became the last bank to settle a class action over lending to WorldCom for \$2 billion. Dimon is rebuilding reserves with \$900 million, which will cut first quarter earnings. Two months ago, he had warned analysts that merger costs would rise yet again. Originally estimated at \$3 billion, the costs were later revised upward to \$4 billion. Then he said they’ll balloon to \$500 million more. Meantime, annual cost savings will reach only 70% of his \$3 billion target by the end of the year. Still, he promised the bank will be in a “fabulous position” by 2006. Says Banc of America Securities analyst John E. McDonald: “What some investors saw as a one-to-two-year turnaround now looks more like a three-to-five-year story.”

In a series of interviews, Dimon and his team of Citi and Bank One vets gave *BusinessWeek* an exclusive look at his ambitious growth plan. Primed with \$1.1 billion of new spending, on top of \$35.5 billion in annual operating expenses, it raises the bar on what he must achieve. That’s because it will eat up over half of this year’s cost savings. Dimon’s strategy reflects three cardinal points of his long-held management philosophy. First, bolster the tech infrastructure to drive efficiency and innovation. Next, invest in businesses that capitalize on strengths, such as consumer finance, debt underwriting, and money management, and rein in those that don’t, like auto leasing. Finally, generate more top-line revenue by selling customers a bunch of new products. Says Dimon, who will succeed William B. Harrison, Jr., 61, as CEO next spring: “We’ve got tons of ideas.”

For starters, he’ll overhaul the retail bank—from fresh paint to new ATMs. He’ll also hire 1,000 salespeople and double, to 14, the number of offices in the Northeast catering strictly to affluent customers with up to \$25 million in assets. He will go na-

tional, spreading his branch network beyond just 17 states. He'll also go global, opening eight private-bank offices abroad, including the bank's first ever in Japan, where regulatory failures led to Citi's private bank being closed. The investment bank, which Dimon admits "has a long way to go," will get new commodities and currency trading platforms partly to snag some of the \$6 billion in fees hedge funds pay Wall Street annually. He's also expanding a nascent 401(k) administration business. "What is growth?" says Dimon, in his trademark staccato style. "It's better service, better products, more hours. Growth to me is every budget review. It's 1,000 small steps."

Small steps to Dimon, but a giant leap of faith for Wall Street. Some investors fear Dimon's cost-cutting will damage the bank's earning power before new revenues click in. He has sold off \$30 billion of Treasury securities that raked in about \$1 billion of income a year, along with \$6 billion in mobile home and recreational vehicle loans. By selling off these portfolios and stashing away reserves far beyond what either regulators or the bank's own targets require, he is building a "fortress balance sheet" capable of



OFF TO THE RACES

Dimon confers with CEO Harrison

weathering rising interest rates and tougher lending markets. Also, he added \$3.7 billion to litigation reserves last year, which will be replenished by another \$900 million after the bank settles the WorldCom class action.

Despite its size, JPMorgan has no retail brokerage, limited international reach, few dealings with the booming hedge-fund industry, and weak equity underwriting and merger advice businesses. Dimon doesn't intend to get into any business "just to say we're in it." All the same, some analysts worry that he'll get sidetracked into joining a bidding war for brokerages Morgan Stanley or Bear, Stearns & Co. should they be put in play, as some expect.

Although many JPMorgan staffers seem happy to have a young, dynamic banker in charge, rather than the courtly Harrison, some find Dimon's blunt, in-your-face management style grating. Last summer he cut programs that matched gifts to charities and 401(k) contributions for the highest paid execs, ranking them. "He's going down like cod liver oil," says one JPMorgan invest-

ment banker. Still, some suspect it cultivates a tough-guy image to keep in line. Tattle about his antics, shouting at people or peremptorily traders, abounds. "If the rumors are true, he certainly doesn't do anything to quash them," says Richard X. Bove, analyst with Punk, Ziegel & Co.

The competitive pressure is unrelenting. Rivals such as Citi and Bank of America are ahead in going national. Regional players like Commerce Bank Corp. and Fifth Third Bancorp. are snapping at Dimon's heels in his markets, New York and Chicago. "They've got all these piranhas nibbling at their core business, and they haven't done anything about it for years," says CreditSights analyst David A. Henkel.

General business conditions won't help Dimon much, either. The mortgage and fixed-income trading business, which made up 20% of JPMorgan's revenues last year—will take

Despite the hurdles, many on Wall Street say Dimon can succeed. They argue that he delivered growth for Wachovia, Primerica, Smith Barney, Salomon Smith Barney and Travelers Group. Says Brad Lasker, analyst at Sanford C. Bernstein & Co.: "He has taken on a major challenge. I'm making a bet that he has the talent and experience to win."

Dimon ran his own show for 10 years at Bank One, the nation's

Dimon's **PLAYBOOK**

Dimon will spend an extra \$1.1 billion this year to kick-start growth. Here's how:

TECHNOLOGY	RETAIL BANK	INVESTMENT BANK	ASSET MANAGEMENT
\$600 million » Overhaul the tech infrastructure by standardizing all the bank's back-office systems. » Build sophisticated trading platforms for the investment bank and big investors. » Develop computer programs to drive investment and credit card sales.	\$300 million » Open 175 branches and install an additional 1,000 ATMs in the U.S. this year. » Rebrand BankOne's nearly 2,000 branches with the Chase name. » Hire 1,000 "personal bankers" to sell Chase home loans and investments at branches.	\$150 million » Court hedge funds for a chunk of their fixed-income and foreign-exchange business. » Securitize more of Chase Home Finance's \$188 billion home-loan portfolio. » Sell services to the old Bank One's 30,000 midsize corporate customers.	\$50 million » Develop investment products that guarantee a positive return, rather than just beating the indexes. » Go after corporate money management and 401(k) plan business. » Open more offices for rich private clients. Add 1,000 salespeople.

bank. A lifelong New Yorker, he and his wife and three then-school-age children moved to the Windy City (he still commutes) in March, 2000. The bank had reported a net loss of \$511 million—result of a mishmash of previous years. Dimon lopped off \$1.8 billion in assets and one-fifth of the workforce. Cuts, he insists, were not his only legacy. In 2003 the bank earned a record \$3.5 billion, nabbing a net 434,000 new checking accounts, vs. 4,000 the year before. The same year credit-card sales rose 83% and home equity loans 29%.

ON INTEGRATION

DID AT Bank One, Dimon is betting on information technology. It will get the biggest slug of extra cash, \$600 million out of an existing \$6.5 billion tech budget. Simply stitching the banks together is a huge task. Over the next 12 to 18 months, thousands of people will spend more than two million hours on 750 different projects just to complete the integration. Nine hundred help desks will be cut and 11 data centers and 150 S. corporate business units, including the New York headquarters, overhauled. "Consolidating systems is an extremely complex, expensive effort," says Paul J. Huet, managing director of compliance specialist Jeffrey Wells Inc. in Seattle.

Dimon's scheme of integrating proprietary technology will play a crucial role in boosting future revenues and profits. "Technology improves accuracy, efficiency, speed, which are the cornerstones of providing client service," says Austin A. Smith, JPMorgan's chief information officer. Nowhere is that clearer than at the bank. Each salesperson at a Chase branch is backed by five support people, compared to one at former Bank One branches. Anyway JPMorgan also spends \$28,300 per employee, more than twice as much as Bank One. Apart from saving hundreds of millions in souped-up software will help staffify prospects for products. For example, it will highlight people with a bank account but no credit card and vice versa. The makeover of the bank's most conspicuous public face, the retail branches, is long overdue. Chase sat idly by as the rest of the industry underwent a renaissance,

sprucing up design, turning tellers into sales associates, and providing come-ons such as free child care and Starbucks coffee. Now, an extra \$300 million will fund projects from retraining tellers to rebranding all of Bank One's nearly 2,000 branches under the Chase name starting this spring. Chase will open 175 new branches and hire 1,000 "personal bankers," who, unlike tellers, earn bonuses based on the number of products they sell. Purchases of smaller banks in fast-growing markets such as Florida, New Jersey, and California are also part of the plan, but will be funded separately.

The new troops will have more to sell as Dimon cranks up the bank's \$800 billion wealth and asset management businesses. On Feb. 22, Bank One's funds, which were tainted in the mutual-fund scandal, quietly disappeared into a newly retitled JPM

Dimon is funneling resources to a 2003 acquisition, Kansas City-based Retirement Plan Services. Last year accounts grew by 40%, with the addition of clients such as Sun Microsystems and Southwest Airlines. Also, some 30,000 midsize companies on Bank One's client roster will be pitched investment banking and cash-management services they didn't have before. That alone could bring \$850 million in revenues, because JPMorgan not only has many more relationships with such companies than commercial banks such as BofA but also more capital from which to offer them loans than the likes of Goldman, Sachs & Co. or Lehman Brothers Inc.

Dimon insists he's not trying to reinvent the classic financial supermarket model that delivers all products to all people. Rather, he is taking rifle shots at businesses he believes have the most potential



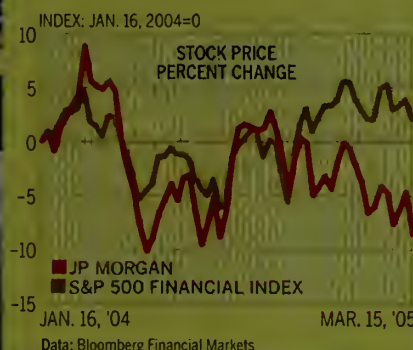
TRADING FLOOR
JPMorgan is targeting hedge funds

Funds, now the nation's fifth-largest fund group, with \$200 billion under management. An extra \$50 million will bankroll a national ad campaign and 150 new fund salespeople. The bank also plans to use its partnership with New York's Highbridge Capital Management—a top-performing \$7 billion hedge-fund company in which it bought a controlling interest last September—to create sophisticated investments that aim to generate positive returns even when the stock market is down.

Renewed selling efforts won't be limited to individuals. While other banks and insurance companies are getting out of in-house money management, it is a big growth area for Dimon. Last year the assets that JPMorgan managed for institutions such as U.S. Bancorp and Prudential Financial Inc. were up 80%, to \$20 billion. The bank is gaining ground in the administration of 401(k) retirement plans, too.

COOL Reception

JPMorgan has fallen behind its peers since it announced the Bank One merger



and he's investing in them even before cost savings are fully in the bag. That's going to make for a rough year for investors who will have to trust that his vision will work. Loyalists say there's nothing to worry about. They credit Dimon, not Weill, with identifying Citicorp as "the mother of all deals" long before its 1998 merger with Travelers. "The Sandy mythology is so large it often obscures the contributions that other people made," says Heidi G. Miller, formerly CFO at Citi and now head of JPMorgan's Treasury & Securities Services unit. Either way, Dimon is in no one's shadow at JPMorgan. Success—or failure—will be all his. ■

—With Emily Thornton in New York, Stanley Reed in London, and Joseph Weber in Chicago

BusinessWeek online To read about Dimon's plans to fix JP Morgan's investment bank, see www.businessweek.com

Look for the Union Label—in Finance

Labor's new plan to manage its own assets could set Wall Street back a bundle

WHEN AFL-CIO leaders gathered in Las Vegas in early March to discuss strategies for reversing labor's decline, they couldn't agree on much of anything. But they did reach a quick consensus on an idea so obvious that it's a wonder no one proposed it sooner: vastly expanding labor's lucrative financial-services businesses. After all, labor-owned companies already sell union members everything from life insurance to credit cards. But the companies don't work together and have never even tried to reach all of the country's 16 million union households.

To make that happen, AFL-CIO President John J. Sweeney appointed a working group to look at consolidating labor's profit-making financial entities into one holding company. The goal: hire professional managers to ramp up labor's efforts in as many financial markets as possible. If it works—a big if, given the many hurdles—the labor movement could capture hundreds of millions of dollars a year that now go to traditional providers such as insurers, credit-card companies, and Wall Street investment managers.

That would add up to a tremendous boon for labor. Doubling, tripling, even quadrupling the AFL-CIO's \$120 million annual budget would give it extensive new resources for recruitment and politics. What's more, managing hundreds of billions of union pension-fund assets—a key part of the plan—would magnify union efforts to influence proxy votes on CEO pay and other corporate governance issues. "Instead of all the profits going to Corporate America, why not put them back into growing the American labor movement?" asks Laborers' Union Presi-

dent Terence M. O'Sullivan, who is also the CEO of ULLICO Inc., a labor-owned life insurer. He put the consolidation idea on the agenda at the Vegas meeting.

The AFL-CIO's new plan is likely to shake up many industries that now provide these services to unions and their members. Almost all the gains unions seek would come right out of the pockets of other companies. Even if labor fails to create successful new ventures on its own, it almost certainly could expand its partnerships with traditional providers, an approach used successfully by nonprofits such as AARP. The seniors group reaps \$300 million a year by offering services such as health insurance and travel that for-profit companies sell under the AARP brand—splitting the fees with AARP.

SCHISM AHEAD?

STILL, LABOR FACES unique problems that other membership groups don't. For one thing, it's in the middle of an increasingly divisive leadership struggle that could muddle the attempt to unify its financial entities. O'Sullivan is part of a group led by Service Employees Interna-

A Money Empire for Labor?

The AFL-CIO is drawing up plans to consolidate labor's assets. By getting unions to steer financial services to in-house entities, it hopes to expand its clout and use profits for goals such as organizing. Union companies operate in:



tional Union President Andrew L. Sweeney, who is unhappy with Sweeney's record. In recent weeks, insider Sweeney has privately told people the Laborers were ever to quit the CIO, as Stern has threatened to oust Sweeney would ask loyal unions to oust O'Sullivan out of his ULLICO job. Sweeney's ally, another Stern ally, United Brotherhood of Carpenters President Doug McCarroll, already split from the AFL-CIO four years ago. At the Las Vegas powwow, Sweeney took steps to remove the Carpenters from related AFL-CIO bodies. If he follows through, McCarroll could lose the \$500 million or so his union has invested in ULLICO and AFL-CIO housing investment trusts.

More broadly, labor has long faced a problem with conflicts of interest re-

BANKING

Amalgamated Bank, owned by the needle trades union, manages \$1 billion in pension assets and offers consumer banking to 500,000 households in California, New York, and the District of Columbia.



One easy move labor can make is to take a bigger role in the management of union pension-fund assets. Right now, various labor companies administer about \$20 billion of the \$400 billion-plus in multi-employer pension funds. They have hired professional staff to manage some of it—such as the AFL-CIO's successful \$3.6 billion Housing Investment Trust, which invests in real estate debt. Most of the rest is co-managed à la AARP, meaning Wall Street firms pick the stocks and bonds and give labor a sales and marketing fee.

A TALL ORDER

IN PRINCIPLE, unions should be able to capture a huge chunk of pension business. After all, union funds are run by trustees who are 50/50 union and management, and the company representatives typically defer to the labor officials. While union trustees are bound by fiduciary obligations, they can favor labor-

owned investment products as long as they're competitive, says Jack M. Marco, chairman of Marco Consulting Group, a Chicago firm that advises union trustees on which investment managers to choose. A labor investment management firm could also bid for business from the \$2.6 trillion public employees pension funds, many of which have union trustees as well.

Labor will probably start by partnering with Wall Street firms, says O'Sullivan. But his goal is to build up in-house investment expertise and eventually take over the stockpicking, too—giving labor

the full management fee. Marco and other experts think that's a tall order, since it would mean competing directly against major Wall Street houses. Still, plenty of firms would be likely to jump at the chance to grab market share by joining with labor. "We'd be happy to become part of the AFL-CIO family, because they could do a better job of bringing in labor assets," says Garrett Walls, who heads up North American institutional asset management at JPMorgan Chase, which manages \$11 billion in union pension funds.

O'Sullivan thinks the AFL-CIO can do likewise in everything from health insurance to home mortgages. For example, ULLICO currently covers 1.1 million union members with a variety of health insurance products supplied by companies such as Medco Health Solutions Inc. But there's plenty of opportunity for expansion, given the nearly 40 million people numbered among the country's 16 million union households.

A labor health insurer could grow quickly using the ULLICO partnering approach. But setting up in-house claims administration or doctor networks to go head-to-head against large insurers would be a Herculean task. "We've invested \$1 billion in technology to handle the oceans of data coming from claims, which would be a significant challenge" for labor, says Cigna Corp. Senior Vice-President Christopher DeRosa, who's in charge of union and government business. About 10% of the 9.7 million people Cigna insures are in union health plans.

If labor, like AARP, becomes a consumer powerhouse with lots of goodies to offer, it might attract more members. "We're service organizations, and we should provide these kinds of services," says International Association of Machinists Research Director Stephen R.

Sleigh. That's a long way off, but if the AFL-CIO comes even close to its vision, the slogan "buy union" could one day take on a whole new meaning. ■

—By Aaron Bernstein in Washington

**16 million
U.S. union
households
make for a
juicy market**

s financial assets. Among the worst was when some Teamsters leaders and mobsters loot their union's pension several decades ago. More recently, a particularly disastrous investment in a Florida hotel a few years ago that ended up several hundred million dollars of the union's pension and other funds. O'Sullivan stepped into ULLICO two years after the prior CEO, a longtime labor leader, left under pressure, accused of running the business into the ground and lining millions for himself in secret ULLICO stock deals. O'Sullivan vows to solve such problems by bringing in professionals to manage the new companies labor would create. Still, they would be in union-owned assets under the ultimate control of labor leaders.

CARDS

earn about \$50 million from Union Privilege, an insurance company that has 3.1 million card holders. It also sells life insurance and other financial

HEALTH INSURANCE

ULLICO, a union-owned company, has a small medical-insurance business that currently issues a variety of products covering 1.1 million union members and their families.

LIFE INSURANCE

ULLICO currently has about 5% of the life insurance market that provides coverage and benefits for the country's 16 million households that include a member of organized labor.

PENSIONS

Labor manages about \$20 billion of the \$400 billion-plus in union pension funds through ULLICO, Amalgamated Bank, and two AFL-CIO real estate investment companies.

The Next Great Baseball Rivalry

The Nationals and Orioles will be fierce competitors—at the ticket window

ON APR. 4, THE WASHINGTON Nationals will officially play ball for the first time—and the boos from Baltimore promise to be almost as loud as the cheers in the Nation's Capital. The Nats and the Orioles, which will compete 37 miles apart, have already skirmished over the marketing of tickets, their attempts to acquire star slugger Sammy Sosa, and the question of how Birds owner Peter G. Angelos will be compensated—a calculation that could affect the location and financing of future franchises.

For Orioles fans there's even the frightening possibility of a Baltimore icon, legendary shortstop Cal Ripken, going over to the dark side. This summer, Major League Baseball will select an ownership group out of at least seven partnerships vying for the franchise. Ripken, who declined to be interviewed, has said he might be interested in joining a Nationals group if he also had a hand in running the team.

The competition between baseball's new neighbors will grow more intense after a Nats owner—expected to pay up to \$400 million—is selected. For now, the Nationals are owned by the 29 MLB team owners, including Angelos. That places the current, MLB-controlled management in a tough spot, trying to avoid even the mildest public disagreements with the Orioles. For example, in the contest to trade for Sosa, baseball sources say the Nats were directed to back off by MLB when Angelos got in the game. Says Nats President Tony Tavares: "Every time we play them, I



hope we kick their butts. But do I wake up wondering how I can hurt the Baltimore Orioles' business and enhance mine? Honestly, no."

Selig already seems to be bending over backward for the Orioles. In September the

SHARP ELBOWS
The Nats and Birds meet in preseason

THE STAT

18,500

Season tickets* already sold by the Washington Nationals

*Includes equivalents such as two half-season tickets

tag around \$360 million if he were the team. That's a tidy profit over the million that an Angelos-led group paid for the Orioles in 1993. For now, the sticking point in the talks appears to be a deal over the Nationals' TV broadcast rights.

PRECEDENT PROBLEM

SOME BIG-LEAGUE EXECS defer to a revenue guarantee, saying it's so unlikely it's unlikely ever to kick in. But other owners point out that in Angelos's situation, some owners might pocket the guaranteed money rather than spend it to improve their teams. There's also the question of the future. "What happens if the team gets put in Portland, Ore.?" the Seattle Mariners get the same [contingent] deal? It creates a precedent problem," says Smith College professor Andrew Zimbalist, an expert on MLB finances.

A major battleground for the Orioles is ticket sales, the franchise's richest revenue stream at about \$10 million per year. Last season the team drew more than 34,000 fans to a game. By the team's estimates, only 10% of its fans live in D.C. suburbs. Attracting those fans will be a challenge. To stem losses, the O's opened season tickets to single games two months early, in December, and four months sooner than the Nationals. "I've never sat down and thought: 'What do we counteract the team doing on the street?' It has given us a new sense of urgency," says Spiro Alafrancesco, the O's chief of communications.

Meanwhile, the Nats could draw the O's. The Nats say they sold the equivalent of 18,500 season tickets for a team that (the Expos) lost 95 games last year and will play in shabby RFK Stadium.

But for diehard O's fans, ticket sales are of little concern compared with the Ripken shocker. To many, it would feel like a fastball off the

bat if Ripken, who played only for the Orioles during a 21-year career, ends up running the Nationals. It could also harden his continuing ties to Baltimore. Ripken owns a minor-league franchise affiliated with the Orioles.

For now, Ripken and Angelos are on friendly terms. A spokesman for the Orioles, whose 2,632 consecutive games played is an MLB record, says he sees the O's owner for lunch about once a month. But that consecutive-meal streak could end fast if Ripken starts commuting to a new job in Washington. ■

—By Mark Hyman in Baltimore

MASS APPEAL? Romney will have to veer farther right to please GOP hardliners

tion, simultaneously trying to govern liberal Massachusetts while courting the Republican base. Romney ran as a moderate reformer who downplayed his Mormon values. But to win the GOP Presidential nomination, he will have to woo evangelicals who have far-right views on taxes, gay rights, abortion, and other issues.

In fact, Romney is already in hot water. His speeches to the conservative faithful in key

primary states such as South Carolina have been alienating voters at home. Romney's unfavorable ratings are up, and his job-approval numbers are down. "If he runs again, he will face a much tougher fight," promises Philip W. Johnston, chairman of the Massachusetts Democratic Party. Indeed, a new poll shows Romney trailing Attorney General Tom Reilly, the probable Democratic nominee, 49% to 40%.

ANGRY BIOTECH

THINGS COULD SOON get a lot uglier. Romney is about to square off with the state legislature over embryonic stem-cell research. Senate President Robert Travaglini, a Democrat, predicts that in late March the legislature will pass his bill allowing so-called therapeutic cloning of stem cells. But Romney says such cloning would create a Brave New Nightmare in which "a genetically complete human being is brought into being...[and then] manipulated and experimented upon like so much research material." Although Romney supports some stem-cell research—including the use of embryos created in in-vitro fertilization clinics—he vows to veto Travaglini's bill.

That has put the governor at odds with the state's biotech industry and Harvard, which last year created a Stem Cell Institute. "Romney is sacrificing the economic future of Massachusetts and the health care of the American people on the altar of political expediency," charges Democratic activist Steve Grossman, president of Boston's MassEnvelopePlus.

Another showdown is looming on gay marriage, which became legal last year af-

Run, Mitt, Run. But for What?

Romney the Presidential prospect has a dilemma—and he's not the only one

DESPITE JUST TWO YEARS in elected office, Massachusetts Governor Mitt Romney is emerging as one of the early heavyweights in the fight for the 2008 Republican Presidential nomination. One reason might be a résumé that reads much like that of George W. Bush. Both men had famous fathers. Both are strong proponents of conservative family values and causes. And both went to Harvard Business School before plunging into business and sports. Romney arguably outdid Bush in those arenas, earning a fortune as CEO of private-equity firm Bain Capital Inc. and rescuing the scandal-plagued 2002 Salt Lake City Winter Olympic Games. "He is a guy of extraordinary talents who thrives for the biggest challenges in the world," says Staples Inc. founder Tom Sturges, an ardent Romney supporter.

Maybe. But first, Romney must resolve an agonizing dilemma: whether to run for reelection in 2006 or devote his energies to a quest for the Presidency. That's a problem facing a number of other Presidential possibilities, including Senator Rick Santorum (R-Pa.) and Governors Tom Vilsack (D-Iowa) and George E. Pataki (R-N.Y.). Senator Hillary Rodham Clinton of New York, the Democratic front-runner, is also up for reelection next year but is considered a shoo-in.

For Romney and the others at risk, it's a high-stakes decision. Holding office gives a candidate instant credibility, visibility, and fund-raising prowess—as then-Governor Bush demonstrated in 2000. But lose a reelection, and you're toast. Just three years ago, for example, Georgia Governor Roy E. Barnes saw his 2004 Presidential dreams disappear when he was upset for reelection by Republican Sonny Perdue.

Romney is in an especially tough posi-

ter a ruling by Massachusetts' highest court. This fall the legislature will decide whether to give voters a chance to amend the state constitution to ban gay marriage but allow civil unions. Although polls show rising acceptance of gay marriage and civil unions, Romney says neither is acceptable.

Romney wins high marks from many execs as a reformer who tackled inefficiencies and patronage. "He has made major strides in bringing more professionalism to state government," says Stephen J. Adams, CEO of the Pioneer Institute, a Boston think tank. Yet even business faults some of the governor's remarks to out-of-state Republicans.

Romney has said being a conservative in liberal Massachusetts is like being "a cattle rancher at a vegetarians' convention." He insists he meant no harm, but "that has not gone over well here," says Brian Gilmore, executive vice-president of Associated Industries of Massachusetts, the top business lobby. "People already have the perception that [this] is a difficult place to do business."

Business complains that closed "loopholes" cost \$500 million

come or sales taxes—is being undercut by complaints from business. Romney says that he raised revenues simply by "closing loopholes." But Michael Widmer, president of the Massachusetts Taxpayers Assn., says that those "loopholes" added up to some \$500 million. "That is a major tax increase," says Widmer, "and clearly a reversal of the progress made in shedding the 'Taxachusetts' image."

For now, Romney promises only that he'll decide whether to seek reelection by this fall. But most political observers are betting that he'll bow out. Like many of his potential competitors, Romney will probably conclude that he has to give up his day job to develop the fund-raising network and national organization he'll need to win the big job. ■

—By William C. Symonds in Boston, with Richard S. Dunham in Washington

BusinessWeek online For a Q&A with Massachusetts Governor Mitt Romney, go to www.businessweek.com/extras

This Trade Pact Won't Sail Through

Expect a bruising CAFTA debate as both parties try to score points with Latinos

IN THE THREE YEARS SINCE Congress handed the White House carte blanche to negotiate free-trade deals, lawmakers from both parties have rubber-stamped a handful of minor pacts. But the Central American Free Trade Agreement (CAFTA), scheduled for Apr. 6 hearings, promises to be a bitter battle as both parties maneuver to appeal to Hispanic voters.

Democrats and their labor allies are closing ranks against CAFTA as harmful to workers in the U.S. and Central America. Meanwhile, the Administration is ready to paint Democratic foes of the pact as anti-Hispanic. "You have six struggling democracies trying to do the right thing," says Christopher A. Padilla, an assistant U.S. trade representative whose grandfather emigrated from Guatemala. "How is a vote against that going to look [to U.S. Latinos]?"

SURROGATES RUSH IN

NERVOUS DEMOCRATS don't care to find out. On Feb. 10, Dems on the Congressional Hispanic Caucus warned new Commerce Secretary Carlos M. Gutierrez, a Mexican-American who will be the point man in the lobbying battle, that they consider "any attempt to inject ethnic rhetoric into this debate highly offensive." For its part, the Administration insists that all Hispanics should support the trade pact as the best hope to encourage economic and political reform in Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras, and Nicaragua.

The deal would attract investment jobs to Central America, the Bush say, while discouraging its apparel industry from fleeing to China.

To promote the deal, ambassadors and other officials from Central America are rushing in. Their message: "Visit your neighbors, and we are poor, and

not a good idea to keep your neighbors poor," says Carlos Sequeira, Nicaragua's CAFTA negotiator. "The real question is, 'Do we want to lose jobs to our neighbors or to China?' Proponents argue that the earnings of Central America's workers will eventually flow back to the U.S. Meanwhile, the Hispanic Alliance for Free Trade—a group organized by the Bush Roundtable and the National Foreign Trade Council—paints CAFTA as a tool to encourage illegal immigration.

Opponents such as Representative Xavier Becerra (D-Calif.), a second-generation Mexican-American who has served for free-trade pacts during 10 years in Congress, argues that CAFTA "will set off a race to the bottom." Other pro-trade Dems and Latin American activists, Becerra says CAFTA will not require Central American governments to protect workers or ban child labor. What's more, foes say CAFTA could devastate the region's farm economies with a flood of U.S. corn and rice.

With polls showing the U.S. public opposed to such free-trade deals, the Administration needs to scramble to win over 30 skeptical House Republicans. Playing the Latino card just might do the trick.

—By Paul Magnusson in Washington



POINT MAN Commerce's Gutierrez got a warning from the Dems

Making Lite of the King

Miller Lite. Can No. 2 keep gaining?

DAYS BEFORE ANHEUSER-Busch Cos. launched Budweiser Select last February, Miller Brewing Co. distributors began wearing buttons that read: "I Created New Bud, Ask Me How." The message: Budweiser Select, with its low carb content and rich color, is just a Miller Lite wannabe. Miller Chief Executive Officer Norman Bramet, Miller has been challenging the beer Goliath—often with cheek—in commercials, stores, and bars. Says Anheuser-Busch marketing chief Michael J. Smith: "Right now, Miller is not making beer business fun."

Miller's stick-in-the-eye formula has produced wonders. Lite, the No. 2 light beer, was the fastest-growing mass-market beer last year. Meanwhile, Anheuser-Busch's first time in nearly a decade failed to gain its U.S. market share. Now, Adams is keeping Lite's fizz from going flat and pumping new life into the rest of Miller. Miller was a case study in lost momentum. The pioneer of the light-beer market in the '70s, Miller's U.S. market share fell from 23% in 1994 to 18% in 2003.

After South African Breweries PLC, which bought Miller from Philip Morris in 2002, Adams left his job as head of the South African unit to run Miller, which accounts for 38% of the company's sales and dug into everything from pricing strategies to bar promotions. "Because of Anheuser's ubiquity and size, we thought that we would have to bump into them to be successful."

Outlining the leader is a timeworn strategy for second-banana brands. But Adams has been especially good at it. Ads in 2003 pitched Miller Lite as the low-carb alternative to Bud Light and hailed Miller as "President of Beers" in 2004, a foil

to Bud's "King of Beers." Anheuser then taunted Lite as the "Queen of Carbs" in ads. That response validated the challenger. "Miller was high-fiving when Anheuser reacted that way," says Daniel J. Howard, a marketing professor at Southern Methodist University.

The payoff for Miller's scrappiness? In 2004, sales of Lite were up 10.5% by volume, compared with just 0.9% for the rest of the industry and 3.7% for Bud Lite.

"THIS ISN'T OVER"

BUT NOW ADAMI needs a second act. With just an 18.5% share of the U.S. market, compared with Anheuser's 49.4%, Adams can revel awhile in the challenger role. But some are skeptical that he can keep playing up Lite's little-guy image and a highly suspect taste advantage. Miller lacks a strong image or brand heritage to rival Bud's Clydesdales. "They've been smart to develop their message into something more than low carbs, but this isn't over, because nobody knows yet what taste means," says Goldman, Sachs & Co. beverage analyst Marc Cohen.

THE STAT

10.5%

How much Miller Lite sales were up last year, compared with 0.9% for all beer and 3.7% for Bud Light



WHY IS THE KING INTRODUCING A NEW BUD TODAY?

- A. Miller Lite is the fastest-growing beer in America*
- B. Miller Lite has more taste and half the carbs of Bud Light**
- C. The King wanted a Budweiser with "no aftertaste"
- D. All of the above
- E. Other

Now that you've taken the quiz, reward yourself with a great tasting Miller Lite.

Good call.

It's also not clear if Adams can rub some of the Miller Lite magic off on the rest of his tired

portfolio. Miller Genuine Draft, Miller High Life, and Milwaukee's Best, which account for 30% of the Milwaukee brewer's sales by volume, have been steadily losing ground. Supermarket sales volume of Genuine Draft have dropped 9% in the past 12 months, High Life is off 7.6%, and Best is off 11.4%.

Beer brands are under pressure as young drinkers migrate from beer to spirits and baby boomers drink lighter brews. But Adams also inherited a bare new-product cupboard. Miller flubbed earlier forays into the sweet malt liquor game, though it's now testing one, Brutal Fruit. "The company has to get something going other than Miller Lite if they want to keep up this turnaround," says Benj Steinman, editor of *Beer Marketer's Insights*.

Adams is confident he will find the right formula for reviving Miller's other brands. It'll be awfully hard. But then again, no one thought he could bring Miller Lite back from the dead. ■

—By Adrienne Carter in Milwaukee

BusinessWeek online For a look at Anheuser-Busch's strategy, go to www.businessweek.com/extras

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Photo Lab Prices— At Home

With new home printers, you can make quality digital snapshots—economically. **BY LARRY ARMSTRONG**

YOU'VE SEEN THE ADS ON TV and in the drug-store fliers that come stuffed inside the Sunday papers: "Digital Prints for 29¢. Half the Price of Printing at Home." That may have been true two years ago when retailers—stung by the sudden drop in their film processing business—were rushing to convert their one-hour-photo labs to handle snapshots from digital cameras. Today, it's a different story: Home printer manufacturers have responded with specialty printers aimed solely at the snapshot market and paper-and-ink value packs designed to match drugstore print prices. I challenged the big printer makers to come up with their best shot. I printed out more than 700 4x6 glossy photos to pinpoint a per-print cost, essentially churning out snapshot after snapshot until the ink cartridges ran dry.

The results? I found that the most economical, Epson's PictureMate printer can produce prints for about 20¢. That beats most retailers' prices down. Snapshots from Hewlett-Packard and Canon printers came in close to drugstore prices at around 30¢ each.

My test was admittedly unscientific: I used a batch of 99 vacation photos I borrowed from a friend who had returned from Africa. Your results may differ, depending on the mix of colors in your snapshots. I used printer and paper combinations identified by their manufacturers as their most economical. You may easily spend 50¢ or more per print with different printers and supplies from the same companies. I didn't factor in the price of the printers, which ranged from \$140 to \$200, basing my calculations solely on the price of the ink and paper.

I shopped for those consumables carefully: Epson, for example, advertises 100 prints from its PictureMate Print Pack, which lists for \$29. But it's easy to find the package for \$25 at office supply stores such as OfficeMax or for \$20 or \$21 online. That means printing 20¢ or 21¢ or even less, since most reviewers say they can squeeze a couple of extra prints out of the ink cartridge. (I got exactly 100 with my photos but, using a second set of photos, I managed to get 176 prints, resulting in a cost of 18¢ each.)

DIFFERENCES IN QUALITY

YOU CAN SPEND a lot more getting photos printed—and you may want to if you want them on heavier paper stock with a semigloss or matte finish instead of glossy, or are worried about fading. If you can take your digital photos to a specialty photo lab instead of the drugstore, you can get a more expensive grade of paper. If you're printing at home, you can choose for the best quality prints, the paper should be the same brand as the printer and ink. Or you can splurge on a professional printer that can handle six or more different colored inks, which makes

Skip the
Drugstore

Some smart gear for producing
prints on your own:

EPSON
PictureMate
20¢

144 seconds per print



CANON
Pixma iP4000
30¢

60 seconds per print

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120 | Barker: Hershey's stock may be too rich



options, including cropping, red-eye removal, and decorative borders.

Another difference: Dell's 540 is a dye-sublimation printer—all of the others are inkjet printers. So-called dye-sub printers use an ink-infused plastic ribbon to thermally transfer the three basic colors and a glossy overcoat from the ribbon to the paper. Because the ribbon, unlike an ink cartridge, is designed to print a fixed number of images, you know your costs in advance. Dell sells a bundle of three of its 40-sheet paper-and-ink print packs for \$47, so your snapshots will cost 39¢ each.

The math for the inkjet printers is more arduous. I printed until the cartridges ran out of ink, divided the cost by the number of prints I got, and then adjusted the result to reflect the

price of the paper. I got 210 prints from HP's \$80, 280-sheet, two-cartridge Photo Value Pack, for example, so I deducted 17¢ for each of the 70 sheets I didn't use. (Staples sells the same HP paper for \$16.94 for 100 sheets.) So each HP print cost me around 32¢.

At times it doesn't make sense to print at home. I would never print 99 snapshots from my vacation, for instance: It took me an hour and a half on the fastest printer, the Canon, and an agonizing four hours on the Epson. That's worth a trip to the one-hour photo store. But if it's one or two or 10, or if you need them now to send off with friends, it's handy to have one of these printers around. And you're not going to feel swindled when the ink runs out. ■

gradations of color and reduces the mess of the print.

PictureMate, a lunchbox-size device with a flip-up carrying handle, can only 4x6 snapshots. That's true as is the HP Photosmart 375 and the Photo Printer 540 that I tested. Each costs around \$190 or \$200. You don't need to connect them to a computer; just pop in the memory card from your camera and start printing. Canon's \$140 iP4000 is more versatile, but it has to be hooked up to a camera or computer. It's more the size of a breadbox, but it can handle 8x10 photos and even letter-size documents as well as snapshots.

A drawback to Epson's PictureMate is its liquid-crystal display screen

can't display pictures, only menus. So if you haven't used your camera to delete the duds, you'll have to print out an index sheet (at the same 20¢ a sheet) to determine which shots you want to print. Similarly, if you want to crop some of your photos, you'll have to print out a guide (another 20¢) that shows your snapshot cropped 18 different ways before you pick the one you want to print.

EDITING OPTIONS

THE HP AND DELL printers display your pictures on their screens, making it easy to pick the prints you want. With Dell's printer, you can do only limited editing, changing the brightness of the print and choosing between "natural" and "vivid" colors. But HP's offers a wealth of editing



HP
Photosmart 375

32¢

105 seconds per print



DELL
Photo Printer 540

39¢

174 seconds per print





COSTA RICA
Teens pitch in on
local projects,
then see the sights

offer teens a chance to work in ages, farms, and animal sanctuaries. Typically, 15 to 20 students travel with three adult leaders—often teachers—over a summer break. They work on a project for at least two weeks, and spend the rest of the time sightseeing and participating in adventure activities such as white-water rafting. In most cases, the project fulfills at least part of a high school's community service requirement.

PHYSICAL HARDSHIP

THE COST TO STUDENTS of digging, manual labor, and sleeping in a hut can range from \$4,000 to \$6,000. "We look to the host communities for technical expertise and help, but we pay for most of the expenses ourselves," says Erik Werner, director of Global Works in State College, Pa. Most programs still have openings for teens, but trips to some exotic locations such as India and Tanzania may be booked.

Teens need to be prepared for physical hardship. Carter Smith, 17, a high school senior in Montclair, N.J., traveled from Putney to Costa Rica after her first year and to India two summers later. In Costa Rica, where she helped build a communal kitchen, she slept in a sleeping bag in a building crawling with bugs. "It was definitely not for everyone," she says.

A good place to look for programs is on the Thomson Peterson's Web site (petersons.com). Once you have settled on a few, speak to teens who have traveled with the groups and their parents. Also ask trip sponsors about evacuation procedures and other measures they will take in case of illness or emergencies. "You need to find out whether the organization has a good track record with a particular country," says Helaine Isaacs, a consultant with Tips on Trips & Camps (tipsandcamps.com).

Carole Lester, 41, who has led trips for Global Routes, says she's usually in daily touch with the U.S. consulate by e-mail or phone. "I was on site in

Kenya when a student needed to reach home. Of the student's parents, our contact in Nairobi drove four hours to meet us," she says.

For parents, sending a teenager to an isolated village can be a nail-biter. For their children, the trip is a challenge that can make a difference in others' lives and their own. ■

A Summer of Service for Teens

Volunteer programs give them the opportunity to do good away from home. **BY SUSAN GARLAND**

THE SUMMER AFTER HER sophomore year in high school, Jaclyn Feldman left her comfortable home in a Washington suburb to spend a month in Belize. But instead of lolling around the beach, Feldman and about 18 other teens traveled inland to a rural village as part of a trip organized by Global Routes of Northampton, Mass. During the days, Feldman mixed cement and sawed metal rods for the foundation of a new school cafeteria. At night, she and another American girl bunked with a local family.

Social critics may bemoan the money-oriented values of teens, but Global Routes and other summer programs that feature community service in places such as Ecuador, Ghana, and Fiji are deluged with applicants. "We're finding that students are willing to step out of their comfort zone," says Jeffrey Shumlin, co-director of Putney Student Travel in Putney, Vt.

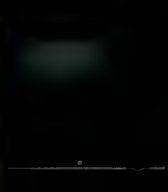
Feldman, 18, now a senior, says when she first arrived at her host family's home, she wasn't sure how she could live in a dark bedroom barely big enough to fit the bunk beds. Also, the family of eight used an outhouse. "By the end, I thought about my house and how ridiculous it was to have all that empty space," she says.

Most programs abroad geared to high school students last about a month and

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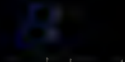


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Chasing Higher Yields Up North

Canadian income trusts are attractive, but there are tax issues for U.S. investors. **BY TODDI GUTNER**

UNLESS YOU LISTEN regularly to the buzz of the Canadian business press, word of the widely popular investments called Canadian income trusts will not have reached your ears. But this is a story U.S. investors will find worth listening to.

These trusts from up north raise capital through an offering of units, or shares. For the most part, trusts use that money to acquire the equity and debt of a single operating company. Because the trust is required to distribute most or all of its cash flow to investors, the trust-owned companies are managed in order to produce cash—lots of it. Often, the original owner retains an interest in the trust and, under a management contract, will direct the operations.

Traditionally, the trusts have invested in oil, gas, and real estate. But the newer ones have been expanding into other businesses with a stable cash flow and little need for new capital investment, such as food processors, pulp mills, even casinos. Over the past three years, thanks mostly to the creation of these so-called business trusts, the number of Canadian

income trusts has doubled, to nearly 200.

In fact, American investment bankers tried to import the Canadian model here in a structure called income depositary shares, or IDS. Since late 2003, a handful of companies in the U.S. have gone public with this model—including B&G Foods, a food processor; Centerplate, a concession-stand operator; and Otelco, a telecom service provider (table). But investor demand for IDS never materialized, so many companies that want to do this are going public in the hot Canadian market.

INCREASING DEMAND

INDEED, CANADIAN INCOME trusts have been on a roll. They racked up a total return of 29% (in Canadian dollars) for the 12 months ended Feb. 28, 2005, according to BMO Nesbitt Burns Trust Composite Index. Add in a currency kicker, an 8% appreciation in the Canadian dollar, and the return for U.S. investors jumped to approximately 37%.

The trusts have shown their stuff over a longer period, too. The five-year total return is 202%, with another 18% currency bonus. They've become so popular that they now account for some 12% of the overall Canadian stock market. That figure is bound to grow because later this year, income trusts are slated to be included in Canada's broad market index, the S&P/TSX Composite Index. That will surely increase demand as institutional investors attempt to replicate the index.

With robust returns and yields up to 12%, there must be a catch. "These are high-yielding equities, not bonds," says John Archer, an investment adviser with

RBC Dominion Securities in Montreal. "There is no protection of principal, no guarantee of the dividend payout, and complex tax rules for reporting the distributions make these investments tricky to own."

Investors should consider a few factors before investing in an income trust: the ability for a trust's underlying business to continue to generate a stable cash flow. Standard & Poor's in Toronto signs a stability rating to trusts, on a scale from 1 to SR-7, with SR-1 the best. "There's a strong reason to think the trusts can sustain its distributions with few variations. The lowest rating, SR-7, shows little confidence in the trust's ability to generate a steady flow of cash distributions. Not all trusts have ratings because they don't want to pay for them."

Since these investments are bought mainly for yield, any cut in cash ca-

Canadian Gems

CANADIAN INCOME TRUST/SYMBOL	YIELD*	EXCHANGE**
Primewest Energy Trust/PWI	11.7%	NYSE/TSX
ARC Energy Trust/AET-UN.TO	9.8	TSX
Enerplus Resources Fund/ERF	9.2	NYSE/TSX
Superior Plus Income Fund/SPF-UN.TO	7.6	TSX
Yellow Pages Income Fund/YLO-UN.TO	6.8	TSX
Fording Canadian Coal Trust/FDQ-UN.TO	4.5	TSX

*As of 11/1/04; yields subject to change.

**NYSE: New York Stock Exchange; TSX: Toronto Stock Exchange.

Data: BMO Nesbitt Burns, BMO



search community," says Dirk Lever, head of business trusts for RBC Capital Markets.

One such giant is Fording Canadian Coal Trust. It's the world's second-largest producer of metallurgical coal, a necessary ingredient in the production of steel. The price of this coal has doubled from \$60 to \$120 per tonne (metric ton) in the past year, and steel mills can't get enough of it. Currently, the trust yields 4.4%, but because of price increases that take effect next quarter, yields are expected to jump to about 14%, say analysts. Can that be sustained? That, in part, depends on continued strong demand for steel.

Superior Plus Income Trust, which yields 7.6%, is a different sort of business trust. Instead of one business, it's in three, but Superior is a market leader in each of them. As a propane distributor, Superior has a nearly 60% share of the Canadian market. It is also the world's second-largest producer of chemicals used to bleach pulp for papermaking. Finally, Superior distributes building materials.

Another business trust, the Yellow Pages Income Fund, a publisher of directories, is acquiring ADS Holdings, also a directories publisher. The deal will make Yellow Pages the nationwide leader with some \$6 billion in revenues (in Canadian dollars). It also has a high payout of 97% of cash flow and a stability rating of SR-2.

Some of the largest trusts, all in the energy and natural-resources sectors, are listed and traded on both the Toronto Stock Exchange and a U.S. stock exchange. The advantage of investing in these trusts shows up at tax time. They make life a little easier for U.S. investors by reporting their distributions in line with the U.S. tax code. "The tax issues are

Closer to Home

U.S. INCOME DEPOSITARY SHARES/SYMBOL	PRICE	YIELD
B&G Foods/BGF	\$15.06	11.3%
Centerplate/CVP	12.92	6.1
Otelco/OTT	15.37	4.6
Coinmach Service/DRY	13.25	2.6

Price and yield as of Mar. 14

Data: Yahoo! Finance

not a question of what form to file but rather how you present the income," says Gary Gartner, the attorney who heads the U.S. tax group for Torys LLP, a law firm in New York and Toronto.

Basically, the cash distributions from trusts are made up of a taxable dividend and a nontaxable return of capital. Trusts that trade only in Canada use local accounting rules to break down the distribution. For the most part, U.S. investors in those trusts end up reporting the distributions to the Internal Revenue Service using the Canadian figures.

EARNINGS ABROAD

FOR THE DIVIDEND, the question is whether it is qualifying—and thus subject to a U.S. income tax of no more than 15%. The tax on nonqualifying dividends can be as high as 35%. Most dividends paid by income trusts are considered qualified dividends.

Of course, dividends earned abroad are often subject to another country's withholding tax. The Canadian government collects withholding tax on the total distribution, both the dividend and return of capital. To avoid paying taxes twice, U.S. investors can claim a foreign tax credit on IRS Form 1116. For dividends, the credit is usually dollar for dollar.

The tax on the return of capital is trickier. The U.S. doesn't tax such distributions. Instead, investors are supposed to reduce their reported cost of the investment by the amount of capital returned. Then, when they sell, they have a larger capital gain, which gets taxed at the 15% capital gains tax rate as long as the investment has been held at least one year. U.S. investors can recover the amount withheld by Canada on the return of capital. To do that, they can use the same Form 1116 to calculate and report an "excess foreign tax credit." The one drawback is that you can't use that credit until the next tax year.

Admittedly, that's a lot of work at tax time. But the hard part is doing it the first time. The benefit of earning those higher yields keeps on going. ■

the stock price. Ken Nesbitt Burns in Toronto, has seen trust prices jump as much as 40%. Fortunately, that hasn't happened here. Since the beginning of 2004 only 8% of the trusts cut their distributions, and some 40% have increased them, and 52% have kept them constant, according to Nesbitt Burns.

Investors need to do the same research they would do before making an investment. Look at the company fundamentals, its position in the marketplace, and the overall economic climate. Liquidity is important, too, so you'll "want to pick from the top 10 or so companies that have a market cap of \$1 billion or more (Canadian dollars) and are widely followed in the re-

U.S. citizens can claim a foreign tax credit to avoid double taxation

Diners Discover The Offal Truth

Organ meats can be the most creative offerings on a restaurant's menu. **BY DAVID KILEY**

THEY'RE THE STUFF of nightmares for vegetarians and squeamish eaters alike: veal cheeks, calves' lungs, sweetbreads, roasted marrow bones, pork brains, and tripe. Collectively known as offal, the innards of various beasts have historically been the fare of peasants, war refugees, coal miners, mountain dwellers, and British barristers. Once found mostly at French bistros and ethnic neighborhood eateries, today dishes prepared with organs are increasingly turning up on menus at esteemed restaurants in New York, New Orleans, Minneapolis, and other cities around the country.

Innovators such as celebrity chef Mario Batali, who slips morsels of gelatinous veal cheek into raviolis at his popular New York restaurants, have been challenging diners for a few years with

innards. But offal took off in earnest last year with the U.S. publication of *The Whole Beast: Nose To Tail Eating* by Fergus Henderson, owner of London's St. John restaurant and the recognized godfather of offal. Why pass up beefsteak for brains? Because you're apt to get a chef's most creative juices. "Order lobster or steak frites and you aren't getting a chef's A-game," says Anthony Bourdain, chef and author of *Kitchen Confidential: Adventures in the Culinary Underbelly*.

TRY A TASTING MENU

MY JOURNEY into offal began in 2001 after weight-loss surgery that narrowed the passage from my gullet to stomach to smaller than a dime. Steaks and chops became too difficult to digest. But organ meats, with less fibrous structures and huge flavors, opened new vistas.

If you're new to offal, a tasting menu is the way to go. I like Onera in Manhattan,



where Executive Chef Michael Psilakis frequently offers a five-course offal dinner for \$50. Dishes range from an adventure-

TASTY Trip with sautéed Asian greens and black mushrooms

somewhat jellied headcheese of pork (the chunky Jell-O flavored with meat gristle) and calf brains with fennel and shallots, to my favorite, a twin nirvana of braised goat heart with artichoke and lemon. The heart closer to game, like elk, than to live.

Sweetbreads (actually the thymus gland of a calf) are the beginner's offal. Done deftly, they have a delicate flavor and disappear in the mouth most without chewing. Onera's are brilliantly with a foie gras dumpling, crushed chicken liver sauce, with a dollop of sheep's milk *crème fraîche* to which to drag each forkful.

The opposite of the nouveau offal are the old world dishes served at French bistros such as Manhattan's Le Tunnel. There, I stared at the \$14 of Tête de Veau (calf's head) like a English major facing a trigonometry problem. The cutlet-size veal cheeks and tongue, a fist of brains were simmered in a sauce with vegetables. With this preparation, the brains tasted like brined packing material.

Tripe, or stomach lining, can be a challenge to a new offal eater. Again, preparation is everything. At Casa Mono, a Spanish tapas restaurant on Irving Place in Manhattan, the crock of veal stock-infused most pasta-like tripe cooked with chickpeas, and finished with four slices of morcilla (blood sausage) was rich enough to be delicious. Organ meats run high in cholesterol, but they're surprisingly. But even a little bit of offal can add an exciting new dimension to your eating. ■

PLEASING PLATTER
Roasted bone marrow



BusinessWeek online For more on offal, the restaurants that serve it, go to businessweek.com/extras

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BY ROBERT BARKER

Beware the Sugar High From Hershey

On Tuesday, Apr. 19, at 2 p.m. in Hershey, Pa., shareholders of Hershey Foods will gather for their annual meeting in an arena often used for hockey. Before them will be votes on directors, an auditor, and, most enigmatically, a change in name. Hershey is dropping "Foods" to become simply Hershey Co.

True, Hershey no longer sells pasta, but along with its familiar candy it's still very much in the cookie, nut, and snack-food business. So why bother with a new name? "We feel that this is how our customers and consumers best know us," a spokeswoman told me. "It embodies the heritage of the company." Does that strike you as the full story? Me neither. The new name's open-ended nature, plus a companion measure before shareholders to authorize a doubling of Hershey's common stock, has investors also wondering if there is more ahead. A big acquisition, maybe of laggardly Tootsie Roll Industries or of Hershey's licensing partner Cadbury Schweppes? Or perhaps it's maneuvering to fend off a takeover, possibly by rival Wm. Wrigley Jr., which courted Hershey back in 2002? In any case, investors are excited: Above \$62, Hershey shares so far this year have jumped 13% and now trade near record levels.

Yet whatever buyers of the stock are imagining about Hershey, chances are they will be disappointed. The stock is full of risk, with two of three outcomes likely to hurt it:

» **Hershey is taken over.** This is the winner for someone in the stock today. Were an acquirer to come calling, the stock in all likelihood would jump even beyond its current highs. The chances of this, however, strike me as slim. In 2002,



Hershey's controlling shareholder trust for the Milton Hershey School, which feeds needy kids, explored a sale of the company. It retreated after widespread alarm among Pennsylvanians and elected representatives. Little on the score has changed. According to Hershey's just-issued proxy statement, the trust "intends to retain voting control." For its part, Hershey insists the stock is not for sale.

» **Hershey makes its own big acquisition.** This possibility is far more plausible than the first, even seems likely in this season of renewed megamergers (think Procter & Gamble-Gillette). Hershey says it's now in any negotiations that would lead to an acquisition in which it might issue the new shares it hopes stockholders will vote to authorize. It wants to have the maximum shares available, a spokeswoman told me.

just to "preserve the company's flexibility" in case an attractive deal turns up. (Another use of the shares would be a stock split, but Hershey split its shares 2-for-1 just last July.) Why would an acquisition hurt investors? It wouldn't, necessarily. Yet stocks of acquirers rarely go up in the near term. This is particularly true of those paying for a deal with stock, a plain signal that management values its stock less than greenbacks.

» **Hershey plows ahead.** With much success under Richard Lenny, now starting his fifth year as chief executive, staying the course would be hard to argue with. Lenny has made some small purchases—the latest, a \$128 million deal for Mauna Loa Macadamia Nut—but mostly has focused on widening margins, extending product lines (Hershey's Kisses got mixed with caramel last year and, this fall, they will get peanut butter), and introducing new ones such as the Tootsie Roll candy bar. The only trouble is the price investors have to pay for reasonable expectations of future profits. You can see this by comparing Hershey with Wrigley or PepsiCo, two companies whose snacks compete side-by-side with Hershey's. A share in Hershey today comes at a comparable or higher price than a share in Wrigley or PepsiCo, yet those earnings are growing more slowly. Nor is Hershey's dividend yield as high (table).

From Almond Joy to Zagnut, Hershey hardly sells a product that doesn't appeal to my mouth full of sweet temptation. As for the stock, I'm abstaining. ■

E-mail: rb@businessweek.com

Value Gap

COMPANY/SYMBOL	PRICE	DIVIDEND YIELD	EBITDA GROWTH*	ENTERPRISE VALUE-EBITDA RATIO**
Hershey Foods HSY	\$62.37	1.4%	7%	14.5
PepsiCo PEP	52.73	1.7	9	12.2
Wm. Wrigley Jr. WWY	67.02	1.7	16	14.3

*Earnings before interest, taxes, depreciation and amortization; current year estimates

**Based on current year EBITDA estimates

Data: Standard & Poor's Financial Research; BusinessWeek

e l e v a t e technology

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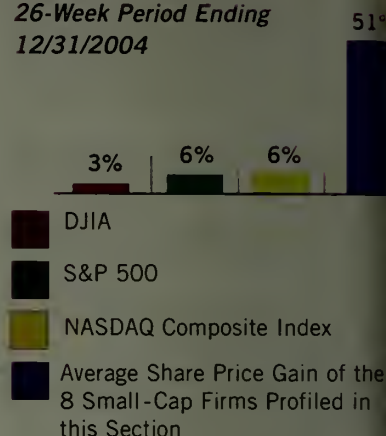
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THE EQUITY INVESTOR'S 26-WEEK SMALL-CAP REVIEW

SELECTED PROFILES OF THE NATION'S TOP PRICE-PERFORMING SMALL-CAP COMPANIES AS OF 12/31/04

From approximately 2,000 domestic companies with market capitalizations of 200 million to one billion dollars, the following pages highlight selected top-ranking firms, in terms of share price performance for the 26-week period ending 12/31/04. Each profile describes a leading company including its industry, market trends and reasons for success, as written by company management. And while past performance is never a guarantee of future results, these top-performing companies represent investment opportunities worthy of a small-cap investor's close consideration.

Gain/Loss for the
26-Week Period Ending
12/31/2004



NovaGold Resources Inc. • NG • Metals Mining

Vancouver, BC, Canada • IR Contact: Greg Johnson • 604-669-6227
www.novagold.net



Founded in 1998, NovaGold is a North American leader in exploration and development of high quality precious metal deposits with active development of four of North America's largest gold and copper deposits including: the 25 million ounce Donlin Creek gold deposit in joint venture with Placer Dome, the multi-million ounce Galore Creek gold-silver-copper deposit, the high-grade Ambler project with Rio Tinto, and the company's deposits in Nome, Alaska — giving the Company one of the largest resource bases of any exploration/development stage gold company at over 19.4 million ounces of gold, 130 million ounces of silver, 8.4 billion pounds of copper and 2.2 billion pounds of zinc. Initial gold production is targeted at 100,000 ounces per year by 2006-07, growing to over 700,000 ounces of gold and 200 million pounds of copper per year by 2010-11. The company has 65.7 million shares outstanding, is well financed with US\$45 million in cash and has no long term debt.

MIPS Technologies, Inc. • MIPS • Semiconductors

Mountain View, CA • IR Contact: Bonnie Gardiner • 650-567-7000
www.mips.com



MIPS Technologies, Inc. is a leading provider of industry-standard processor architectures and which licenses its intellectual property to semiconductor companies, ASIC designers and system OEMs.

We and our licensees target high-growth, high-volume markets such as digital consumer, networking and communications, smart mobile, automotive telematics and office automation. Many of the world's most popular products are powered by the MIPS architecture, which has the distinction of being number one in many compelling markets including: video game consoles; cable, DSL, ADSL, VDSL modems; high-end routers, color laser printers and color copiers.

Key Manager Statement

"With steady revenue and profitability growth, a record rate of licenses, leadership in key markets like broadband and DTV markets, a product portfolio with clear performance, and power advanced design activity in our customer remains robust and we are attracting opportunities with customers formerly used competitor products."

John Bourgoignie, President and CEO

Terra Industries Inc. • TRA • Chemicals

Sioux City, IA • IR Contact: Joe A. Ewing • (712) 277-7305
www.terraindustries.com



Terra Industries Inc. is a leading international producer of essential nitrogen products for agricultural and industrial markets. The company owns and operates six nitrogen products manufacturing facilities in North America and two in the U.K. It also owns a 50% interest in a Trinidad ammonia manufacturing facility. Terra's strengths include high quality assets, well-positioned plants, excellent supply chain management, superior reliability and a strong financial position. Terra reported 2004 income available to common shares of \$66.6 million, or basic earnings per share of \$.87, on revenues of \$1.5 billion. Terra employs approximately 1,250 people and is headquartered in Sioux City, Iowa.

Key Manager Statement

"Terra is well positioned to serve its nitrogen markets. We have strategically located and competitively advantaged inland facilities, significant market share, an experienced management team and labor force, diverse product and feedstock sourcing capabilities, substantial liquidity and limited cash needs and debt maturities until 2008."

Michael L. Bennett,
President & CEO

Sociedad Química y Minera de Chile • SQM • Minerals

Santiago, Chile • IR Contact: Patricio Vargas • +(56) 2 425227
www.sqm.com



SQM, a Chile-based company with revenues of approximately USD 800 million and offices in 20 countries, is the worldwide market leader in three growing businesses: specialty plant nutrition, iodine and lithium. These products, sold in more than 100 countries, are critical components in a great variety of industries, from high quality, high yield crops to lithium batteries and medical applications. SQM's strategy of strengthening its three main business areas is supported by its global reach, its access to unique and vast natural resources, low production costs, operating efficiencies, commitment to quality and a solid financial position.

Key Manager Statement

"Four years of continued growth in revenues and earnings, even in declining price scenarios, prove our discipline and commitment to our shareholders. Today, as our markets are recovering, we are solidly positioned to keep growing during the next years, creating value for our shareholders."

Patricio Contesse, CEO

THE EQUITY INVESTOR'S 26-WEEK SMALL-CAP REVIEW

Yamana Gold Inc. • AUU • Metals & Mining

Ontario, Ontario, Canada • IR Contact: investor@yamana.com
www.yamana.com

Yamana Gold Inc. was formed in Aug. 2003 and is listed in Toronto (YRI:TSX), New York (AUU:AMEX) and London (YAU:AIM). As a Brazilian gold producer, it is rapidly joining the ranks of an intermediate producer. Company operations and assets (100%) include: two producing mines; two currently under construction; a feasibility stage project; and an unparalleled American exploration portfolio. Production in 2004 was approximately 1.2 million oz of gold and is expected to increase to over 145,000 in 2005; 300,000 in 2006; and 400,000 in 2007. Copper production from its copper/gold mine is expected to increase to 100 million lbs annually in 2007.

Key Manager Statement

"Our management team is highly skilled in construction and operations and it has also financed Yamana's future programs, including an exploration program on an estimated 1 million hectares of promising exploration concessions in Brazil. Investors can expect to hear more about Yamana as it continues its focused strategy of building shareholder value from a strong existing property platform."

Peter Marrone, President & CEO

Petroleum Development Corporation • PETD • Energy

Midland, WY • IR Contact: Celesta Miracle • 304-842-3597
www.petd.com

Petroleum Development Corporation (NASDAQ: PETD) (PDC) is a rapidly growing independent oil & gas producer. Founded in 1969, the Company's drilling and production operations are in the Rocky Mountains, Appalachian Basin, and Michigan. Approximately 83% of the Company's 2004 production was natural gas, and over 70% of production was provided by the Rocky Mountain operating area. PDC also owns and operates an Appalachian-based natural gas marketing company. Sustained profitable growth is PDC's principle. PDC had record operating results again in 2004. Few companies match the Company's record of increasing reserves, production and shareholder value over the past decade.

Key Manager Statement

"PDC achieved exceptional operating and financial performance in 2004 through developmental activities and growth of its partnership business. PDC continues to expand its technical, geological, and operating expertise to generate and exploit new opportunities."

Steven R. Williams,
Chairman & CEO

Chemed Corporation • CHE • Healthcare

Cincinnati, OH • IR Contact: David P. Williams • 513-762-6901
www.chemed.com

Formed in 1971, Chemed operates two wholly owned subsidiaries: VITAS Healthcare and Roto-Rooter. VITAS is the nation's largest provider of hospice care. Hospice is focused on making the terminally ill patient's final days as comfortable and free as possible. These services include direct medical care as well as emotional and spiritual counseling for the patient and family. VITAS provides hospice care to over 9,000 patients daily in 35 states through programs in 12 states. Roto-Rooter is a leading provider of plumbing and drain cleaning services in North America. Roto-Rooter operates in more than 100 company-owned locations, and over 100 franchise territories, serving approximately 91% of the U.S. population.

Key Manager Statement

"Chemed is focused on driving future growth from investing in existing business segments. VITAS' growth will be from organic growth, new starts and acquisitions. Roto-Rooter is focused on maximizing same-store growth as well as expanding geographic coverage through the repurchasing of franchises."

David P. Williams, CFO & VP

DIRECTORY

NovaGold Resources Inc. (NG)

604-669-6227

MIPS Technologies, Inc. (MIPS)

650-567-7007

Terra Industries Inc. (TRA)

712-277-7305

Sociedad Química y Minera de Chile (SQM)

(56)-2-4252274

Yamana Gold Inc. (AUU)

investor@yamana.com

Petroleum Development Corporation (PETD)

304-842-3597

Chemed Corporation (CHE)

513-762-6901



BY GENE G. MARCIAL

BEATEN-DOWN AMR LOOKS POISED TO FLY A LOT HIGHER.

OSHKOSH TRUCK LOADS UP ON MILITARY AND CIVILIAN ORDERS

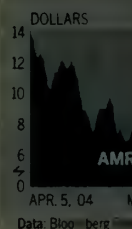
FOODMAKERS ARE HUNGRY FOR SENOMYX FLAVOR ENHANCER

Airlines: Buy American?

A **VALUE PLAYER** who looks for well-known but depressed stocks in troubled industries, Vince Carino winds up with some out-of-favor companies. One such is AMR (AMR), parent of American Airlines, the world's largest carrier. Its stock, which soared as high as 40 in 2003, has plunged to 8.65—down from 13.93 on Apr. 5, 2004. Airline stocks have dived some 25% this year, mainly because of high fuel prices. But Carino, chief of equity investments at Fidelity National Financial, which has bought shares, is convinced AMR will hit 50 in two years. Yes, 50. He sees AMR boosting fares and sales amid reviving traffic and contracting capacity. To offset fuel increases, AMR and Northwest upped fares on Mar. 11 for most flights in the U.S. and Canada—by as much as \$20 for a round trip—the second increase in two weeks. Other airlines quickly followed suit. Carino says the top and bottom lines he sees for

AMR—adjusted for competition and based on fare hikes and cost-cutting—are extraordinary and far exceed the Street's forecasts. Carino expects AMR to be still in the red in 2005, on revenues of \$20 billion, but should earn \$460 million, or \$2.80 a share, in 2006 on sales of \$23 billion and \$1.7 billion, or \$10 a share, in 2007, on \$25 billion. Carino notes that AMR traffic in the past two months has risen 5.3%, to 20.17 billion revenue passenger miles, up from 19.6 billion a year earlier, and average seat occupancy has leaped from 69% to 73%. Susan Donofrio of investment firm Fulcrum Global Partners (she owns shares), rates AMR a buy, with a 12-month target of 17. She expects AMR to ask employees for further wage cuts, and to increase revenues adding airplane seats and revving up the international business.

AT LOW ALTITUDE



30 Blue Chips in one

Diamonds (DIA) are all 30 gems of the Dow Jones Industrial Average wrapped up in one neat exchange traded fund and of course, they are subject to similar risks. Ask your advisor for details. It's a smart way to add luster to your portfolio.

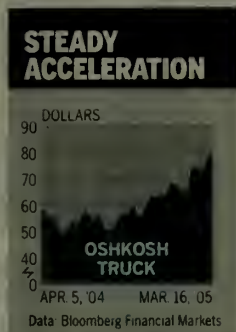


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Oshkosh Truck Barrels Along

RES OF OSHKOSH TRUCK (OSK), a maker of military and commercial vehicles, have ramped up fast—from 48 in May to 79.37 on Mar. 16. And investors believe they have a ways to go. Guy Dong of Munder Capital Management, which owns stock, sees the stock rising 95 in a year, on rising sales of trucks—34% of sales and 71% of profits—to the U.S. military in Iraq and elsewhere. A big plus: the construction boom that has boosted demand for cement mixers and even fire trucks. Also on the rise is demand for ambulances and fire trucks. Sales are apt to benefit from further Army contracts, he adds. Also boosting orders, he adds, is the rise in federal spending for homeland security. Robert McCarthy of investment firm Robert W. Baird, which has provided investment banking services to Oshkosh, rates the stock “strong buy” and sees earnings of \$4.10 a share for the year ending Sept. 30, and \$4.75 in 2006, vs. \$3.13 in 2004.



Meet or Salty with Senomyx

WHEN CITIGROUP took biotech outfit Senomyx (SNMX) public on June 21, 2004, at 6 a share, there was scant interest. By Aug. 12 it had slipped to 4.50, but investors should have paid more attention: The

stock has since doubled, to 11.98. Senomyx has developed a taste-receptor technology that intensifies salty or sweet flavors. Since last September, Nestlé, Coca-Cola, Campbell Soup, and Kraft Foods have signed up to use Senomyx compounds. “The ability to reduce sugar, salt, or artificial flavoring without sacrificing taste is a huge opportunity in this health-conscious society,” says Robin Manners West of New Mexico’s State Investment Council, which has purchased shares. Each compound, she says, works on a different flavor, so foodmakers can calculate how much to cut back on sugar, salt, or monosodium glutamate. On Mar. 3 two of Senomyx’ enhancers got approval from the Flavor & Extract Manufacturers Assn., typically endorsed by the Food & Drug Administration, which dubbed them “generally regarded safe.” These are the only approvals Senomyx needs. It expects its first sales in the first half of 2006, notes Steve Cohen of investment outfit Kellner DiLeo Cohen, which owns shares. He figures Senomyx will start making money only in 2007, given Senomyx’ marketing timetable. He expects the company to earn 77¢ a share in 2007 and \$1.50 to \$2 in 2008. His 12-month price target: 20. ■



BusinessWeek online

Gene Marcial's Inside Wall Street is posted at businessweek.com/today.htm at 5 p.m. EST on the magazine's publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor their firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.

Package. Brilliant.

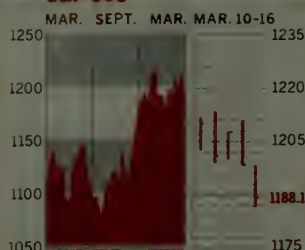
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STOCKS

S&P 500



COMMENTARY

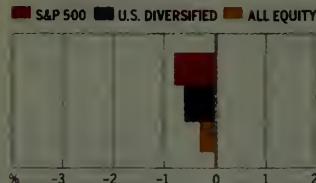
Stocks lost ground for the week, shaken by GM's forecast of a huge loss for the first quarter. Although hardly a shock to most who have followed the carmaker's decline, investors headed to the sidelines ahead of other bad news. And while the S&P 500 is trading at a reasonable 15.6 times estimated '05 earnings, equities are caught in a vise of rising interest rates, commodity prices, and inflation.

Data: Bloomberg Financial Markets, Reuters

MUTUAL FUNDS

4-WEEK TOTAL RETURN

WEEK ENDED MAR. 15



52-WEEK TOTAL RETURN

WEEK ENDED MAR. 15



Data: Standard & Poor's

U.S. MARKETS

	MAR. 16	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	1188.1	-1.6	-2.0	7.0
Dow Jones Industrials	10,633.1	-1.6	-1.4	4.4
NASDAQ Composite	2015.8	-2.2	-7.3	3.7
S&P MidCap 400	664.6	-0.8	0.2	13.0
S&P SmallCap 600	325.7	-1.2	-1.0	17.9
DJ Wilshire 5000	11,713.4	-1.4	-2.0	8.0

SECTORS

	MAR. 16	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
BusinessWeek 50*	708.6	-1.9	0.6	14.1
BW Info Tech 100**	353.2	-2.3	-5.4	3.1
S&P/BARRA Growth	570.6	-1.8	-2.0	4.2
S&P/BARRA Value	613.2	-1.3	-2.0	9.7
S&P Energy	337.5	-1.4	16.9	44.2
S&P Financials	393.7	-1.4	-4.2	-0.1
S&P REIT	134.5	-0.3	-6.9	8.4
S&P Transportation	225.7	-2.5	-6.5	22.3
S&P Utilities	147.8	0.4	4.4	21.5
GSTI Internet	153.5	-2.9	-13.9	12.4
PSE Technology	728.9	-2.0	-6.4	5.1

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS

	MAR. 16	WEEK	% CHANGE YEAR TO DATE
S&P Euro Plus (U.S. Dollar)	1422.8	-1.1	1.8
London (FT-SE 100)	4937.6	-1.2	2.6
Paris (CAC 40)	4019.4	-1.2	5.2
Frankfurt (DAX)	4309.1	-1.5	1.2
Tokyo (NIKKEI 225)	11,873.2	-0.8	3.3
Hong Kong (Hang Seng)	13,832.5	-0.8	-2.8
Toronto (S&P/TSX Composite)	9712.6	-0.8	5.1
Mexico City (IPC)	13,096.6	-4.2	1.4

FUNDAMENTALS

	MAR. 15	WEEK AGO
S&P 500 Dividend Yield	1.99%	1.95%
S&P 500 P/E Ratio (Trailing 12 mos.)	20.0	20.3
S&P 500 P/E Ratio (Next 12 mos.)*	16.1	16.5
First Call Earnings Revision*	0.67%	0.47%

TECHNICAL INDICATORS

	MAR. 15	WEEK AGO
S&P 500 200-day average	1148.5	1146.1
Stocks above 200-day average	73.0%	76.0%
Options: Put/call ratio	0.80	0.72
Insiders: Vickers NYSE Sell/buy ratio	4.81	4.74

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Department Stores	8.8	Steel	83.2
Railroads	8.4	Oil & Gas Refining	75.1
Oil & Gas Exploration	7.3	Fertilizers & Ag. Chems.	71.4
Divsfd. Metals & Mining	6.8	Oil & Gas Exploration	60.0
Home Furnishings	6.3	Internet Software	48.2

WORST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Automobiles	-15.6	IT Consulting	
Internet Retail	-15.4	Insurance Brokers	
Biotechnology	-11.2	Electric Mfg. Svcs.	
Food Chains	-10.8	Automobiles	
Auto Parts & Equipment	-10.6	Semiconductor Equ	

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Precious Metals	6.0	Natural Resources	42.4
Natural Resources	4.9	Latin America	40.1
Europe	2.1	Europe	27.2
Foreign	1.7	Utilities	24.7
LAGGARDS		LAGGARDS	
Technology	-3.8	Technology	-2.4
Latin America	-2.9	Health	1.5
Health	-2.5	Large-cap Growth	5.4
Communications	-1.8	Precious Metals	6.2

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Oppenheimer RI. Asst. A	14.0	ProFunds Oil & Gas Inv.	71.1
ProFunds Pr. Mtls. Inv.	10.2	BlackRock GI. Res. Inv. A	61.7
U.S. GI. Invs. Prec. Mtls.	9.9	iShares MSCI Austria Idx.	60.4
PIMCO Cmdty. R. R. Instl.	9.9	U.S. GI. Invs. GI. Rscs.	54.8
LAGGARDS		LAGGARDS	
PIMCO RCM Biotech. D	-11.4	Ameritor Investment	-46.9
ProFunds Biotech. Inv.	-10.8	Apex Mid Cap Growth	-29.2
Ameritor Investment	-10.5	ProFds. USH. Mid Cap Inv	-27.3
Amerindo Technology D	-10.2	ProFunds Semicdr. Inv.	-26.4

INTEREST RATES

KEY RATES

	MAR. 16	WEEK AGO
Money Market Funds	2.15%	2
90-Day Treasury Bills	2.79	2.75
2-Year Treasury Notes	3.70	3.70
10-Year Treasury Notes	4.51	4.52
30-Year Treasury Bonds	4.79	4.80
30-Year Fixed Mortgage †	5.93	5.80

†Ban

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR BOND
General Obligations	3.11
Taxable Equivalent	5.44
Insured Revenue Bonds	
Taxable Equivalent	5.59

THE WEEK AHEAD

PRODUCER PRICE INDEX

Tuesday, Mar. 22, 8:30 a.m. EST » February producer prices probably rose 0.3% for a second straight month. That's the median forecast of economists polled by Action Economics. Excluding food and energy, core prices most likely edged up by 0.1%, after a 0.8% jump in January.

FOMC MEETING Tuesday, Mar. 22, 9 a.m. EST » The Federal Reserve's Open Market Committee

will gather to set monetary policy. In the Action Economics survey, economists were unanimous in their expectations for a quarter-point hike in the federal funds rate, to 2.75%.

CONSUMER PRICE INDEX

Wednesday, Mar. 23, 8:30 a.m. EST » Consumer prices for goods and services most likely increased by 0.3% in February, after a 0.1% gain in January. Excluding food and energy

categories, prices probably rose 0.2% for a fifth consecutive period.

DURABLE GOODS ORDERS

Thursday, Mar. 24, 8:30 a.m. EST » Orders for durable goods in February are expected to have increased by 0.7%, after a 1.3% fall in January.

NEW HOME SALES Thursday, Mar. 24, 10 a.m. EST » February new-home sales probably stood at a 1.14 million annual rate, up from 1.11 million in January.

The BusinessWeek production index moved up to 238.3 for the week ended Mar. 5 and 11.3% from a year ago. Before calculation of the week moving average, the index improved to 239.6.

BusinessWeek on

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/magazine/

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BusinessWeek (ISSN 0007-7135) Issue number 3926, published weekly, except for one week in January and one in August, by The McGraw-Hill Companies, Inc. Executive, Editorial, Circulation, and Advertising Offices: 1221 Avenue of the Americas, New York, N.Y. 10020. Periodicals postage paid at New York, N.Y., and at additional mailing offices. Canada Post Publication Mail Agreement Number 40012501. Return undeliverable Canadian addresses to: DPGM Ltd., 4960-2 Walker Road, Windsor, ON N9A 6J3. Email: bwcustomerservice@needata.com
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The Apple Case Isn't Just A Blow to Bloggers

THE BLOGOSPHERE took a hit recently when a California judge ruled that Web loggers must reveal their sources for confidential Apple Computer Co. documents that they posted on their sites. But the collateral damage in that case may spread to all media, including the business press, by undermining its role in disseminating information to the public. Apple certainly has the right and obligation to seek prosecution for those who stole its intellectual property. But the transmission of information to the public at large is the job of the media, both online and off.

Against the wishes of powerful people trying to control information, the media have revealed corruption in Enron, WorldCom, and elsewhere in Corporate America, as well as questionable government policy going back to the Pentagon Papers. In a free society and a free market economy that depend so much on information, the media play a key role.

Clearly, there are built-in tensions between the media's dissemination of information to the public and the demands for secrecy from the government and industry. But courts have been adjudicating that for many years. The newer issue arising from the Apple case concerns the position of bloggers as journalists in America. The judge ducked the question of whether or not bloggers deserve the same First Amendment and state shield law privilege to protect sources that mainstream journalists possess. That was unfortunate. In principle, it's only fair to say bloggers acting like journalists are, in fact, journalists—regardless of what platform they use. America has a long history of pamphleteers expressing their views, and it has extended First Amendment rights to nearly all of them over the years. Bloggers are no different.

But in practice, the prospect of 10, 20, or 50 million bloggers claiming journalistic privilege terrifies judges and First Amendment lawyers alike. They fear that anyone who has a Web site, if called to testify by a grand jury, could claim the privilege and refuse to cooperate. The flow of information to the judicial system could dry up as courts spend countless hours balancing the need for testimony against the public's desire for information and the blogger's demand to protect sources to give it to them. The great fear is that the courts will simply get overwhelmed and judges

won't extend First Amendment protection to any journalist, regardless of medium. The courts will, in effect, say that the privilege extended to nearly everyone is a privilege that no one should receive.

What to do? At the risk of being accused of being an elitist, we believe we must face the judicial reality and begin a conversation about who is a journalist. Courts have struggled with this issue for some time. The 31 state shield laws already on the books can't help.

Most argue that you must work at some kind of media organization, be it a newspaper, magazine, TV show, or something else, to be awarded special privilege. A number of states define journalists functionally, as newsgatherers or investigative reporters. So a certain regularity and consistency in posting information would help qualify a blogger as part of the media. Being independent and not on the payroll of an organization you are covering would also be part of the definition (whistleblowers aren't journalists but are protected by different laws). The number of people bloggers reach

Why should bloggers be denied rights given a pamphleteer in the past?

also be a consideration, but it can become tricky. If only your Mom reads your blog, are you really a member of the media?

It's easy to see where these philosophical problems may emerge. Employees who use their companies' trade secrets on their blogs can't be journalists. They're thieves. What if they've been blogging for a long time, providing information to many people? Do these bloggers have First

Amendment and state shield law privileges protecting themselves as sources? It's a very complex issue.

Over time, the courts and the law have extended journalistic privilege to an ever-wider range of people. Freelance writers are now covered, as well as book authors and scholars. The courts have split on giving academics privilege but have extended it to such political advocacy groups as the Anti-Defamation League.

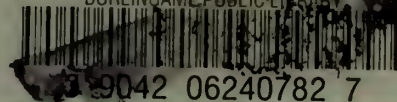
What is needed is yet another expansion of the criteria to encompass those bloggers who truly practice the craft of journalism. Technology has liberated individuals from having to work within any specific journalistic organization and time for the law to recognize that fact. Both the media and the courts will be grappling with this issue for years. But by the criteria already on the books, the blogger sued by Apple who runs the ThinkSecret.com site, is a real journalist.

ss Week

April 4



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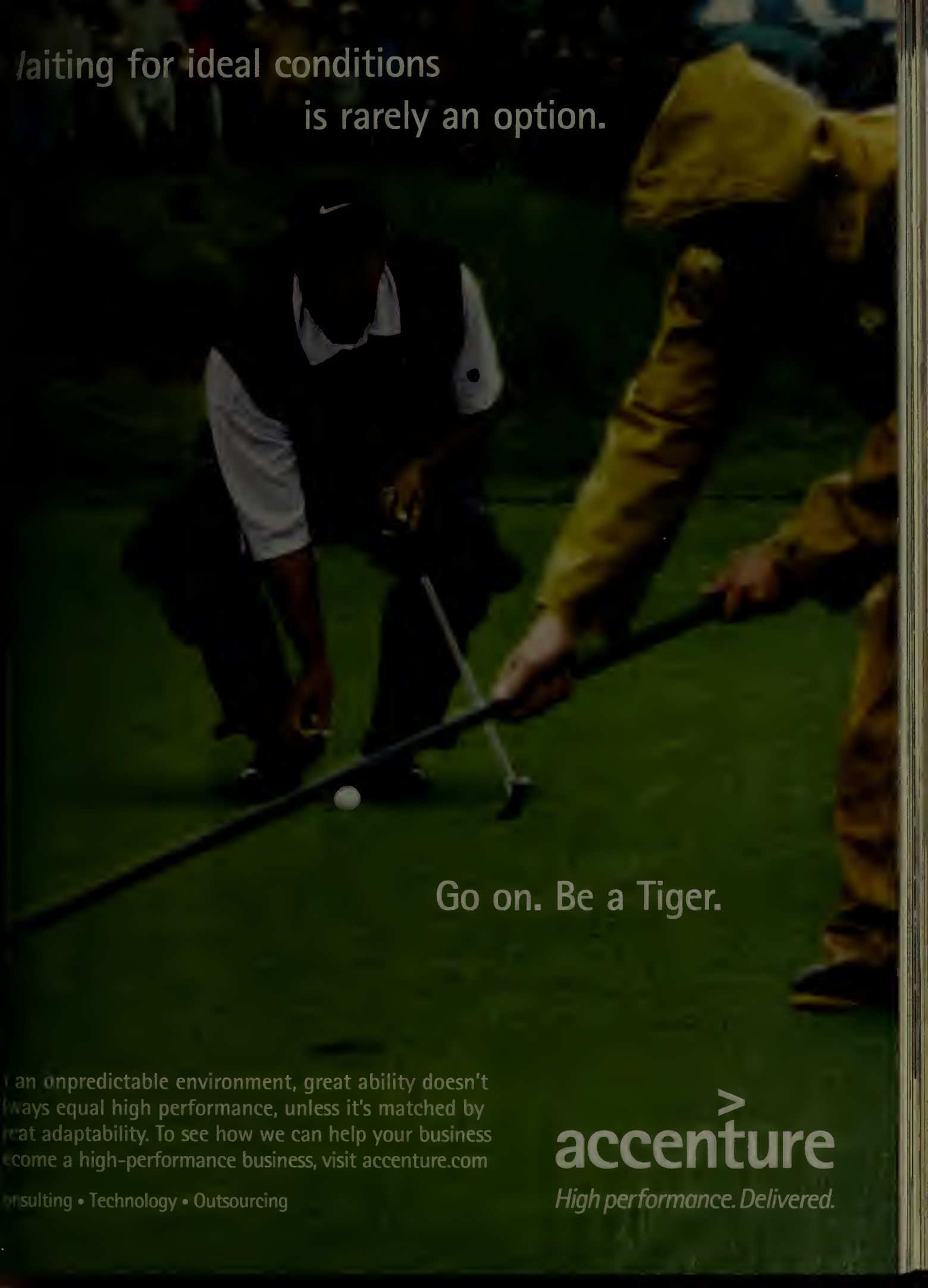
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The background of the cover features a large, abstract graphic design. It consists of several overlapping circles and semi-circles in three primary colors: a deep red, a bright white, and a solid black. The red circle is the largest and is positioned in the lower-left and center. A white circle is partially visible within the red one. To the right, a large black semi-circle overlaps the red one. The overall composition is minimalist and modern, with high contrast between the colors.

Top Story

BusinessWeek 50
 Year's list of America's
 performers is the most
 in the ranking's
 , reflecting a trend in
 s. economy toward
 growth across
 l sectors. Heavy
 ry and Big Oil make
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 h companies,
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 est—and most
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ng on Wings of Steel
 apped up 10 minimills during
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ware Vet's Growth Spurt
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 after 23 years

Cautious King of the Oil Patch
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 lenge for Yahoo! is to establish
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Dow Got Its Man
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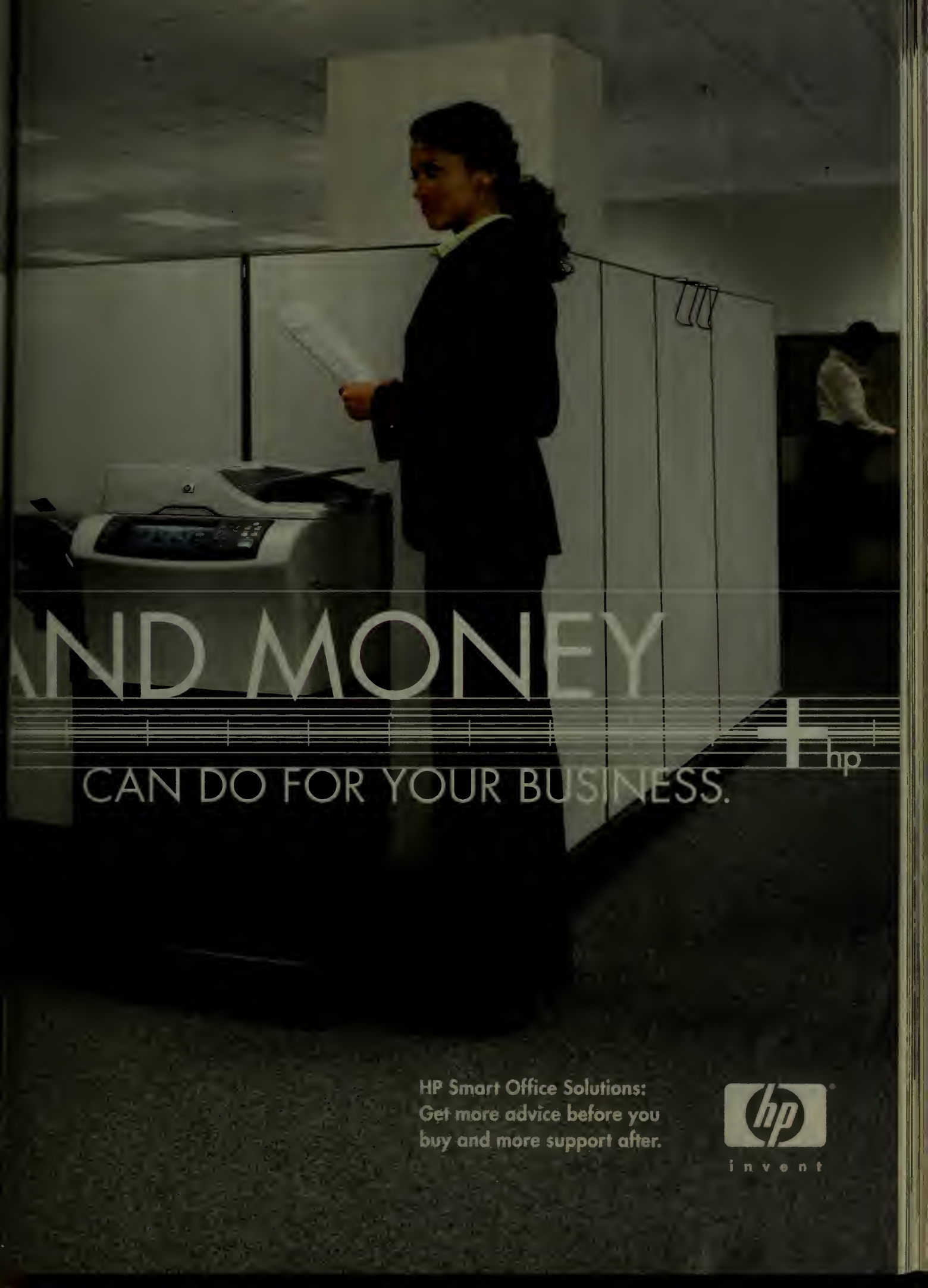
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FRIDAY, AUGUST 27, 2005 - VOL. CCLXII NO. 43 - ***** \$1.00

When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

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The Best Perform

Memo to Apple: Take It Easy on Your Fa

Steve Jobs is on the warpath against leaks about yet-to-be-released products appearing on Machead Web sites like ThinkSecret.com. But is this a group the company really wants to alienate?

The Final Four: Is It An Economic Air Ball?

Boosters may claim otherwise, but cities that host the NCAA's hoops finale generally reap no payoff, says economist Victor Matheson. Waves of out of towners tend to scare away locals, offsetting any windfall



Pop! Goes the Auto Bubble

Detroit beware, says *BusinessWeek* Chief Economist Michael Mandel. GM's bad news is just the beginning. With oil prices and interest rates rising, the fast times for auto and SUV sales are ending—and the road ahead could be very rough

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PROFESSION: PILOT CAREER: ACTOR

Photographed by Patricia von Ah on the private runway of John Travolta's residence in Ocala, Florida.

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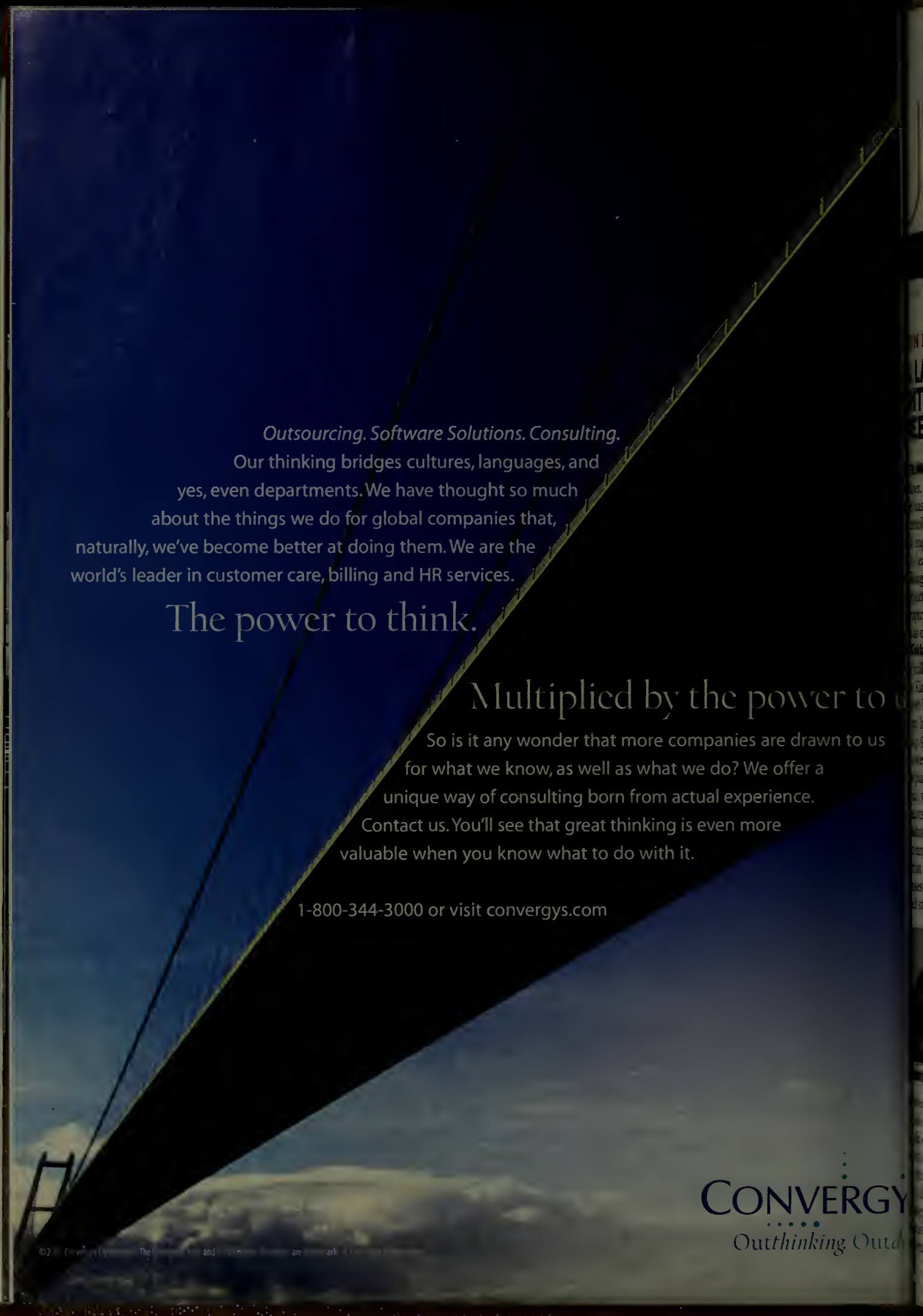
If you are acquainted with the star, the multi-faceted actor. But John Travolta is also a seasoned pilot with more than 5,000 flight hours on his belt, and is certified on eight different aircraft, including the Boeing 747-400 Jumbo Jet. As a young boy in New Jersey, he already used to dream of flying as he watched planes criss-crossing the sky over the New York airports. Today, John Travolta travels the world at the controls of his own airliner and nurtures a passion for everything that embodies the authentic spirit of aviation. Like BREITLING wristwatches. Founded in 1884, BREITLING has shared all the finest hours of aeronautical history. Models such as the NAVITIMER have become cult watches for pilots the world over. Where safety is of crucial importance, BREITLING is known as the specialist in reliable and high-performance "flight instruments" designed and tested for the most demanding professionals. BREITLING chronographs meet the highest standards of precision and functionality, and are equipped with movements that are COSC-certified by the COSC (Swiss Official Chronometer Testing Institute) – the highest reference in terms of precision and reliability. One simply does not become an aviation supplier by chance.



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—Pax World Funds Vice-President Anita Green on the fund's decision to divest from Starbucks after the company launched an alcoholic drink

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ON BLUES

LAWYERS: EIGHT DAYS A WEEK?

FILING for Chapter 11 in November, 2002, **United** has lost \$4.5 billion. Contributor, says the engineers union: The lead law firm is billing. The union objections with the bankruptcy judge about what as out-of-control fees **Kirkland & Ellis**—a total \$4 million.

The Kirkland lawyer billed 600 hours last year at an hour—the same as 9.6 hours a day, 7 a week, all year. Another partner bills at \$950 an hour, while some legal assistants get \$230 an hour. Kirkland says the union has any basis for its conclusion that K&E's fees and charges are unreasonable." It says all fees have been



IN THE BAG CEO Frankfort gets \$53 million in options

PERK PARADE

Fatter Envelopes

EXECUTIVE PAY is on the rise—again. Compensation consultants say 2004 will be one of the best in recent memory, with CEO pay likely to rise as much as 20%. Strong profits boosted bonuses, while surging stocks increased option values. And a shift from options to restricted stock—to reduce the impact of options expensing set to start in June—resulted in some large stock grants. Says New York pay consultant James Reda: "It's another

year of big increases."

To avoid distortions created by large option exercises, *BusinessWeek's* measure of exec pay excludes those windfalls but includes the Black-Scholes value of

annual option grants. That's why **Coach** CEO Lew Frankfort is at the top of our preliminary list of highest-paid execs. His \$53 million options grant was the largest so far.

The change reveals that pay for performance is, for the most part, working. The CEOs on our list (below) all run companies that were strong performers last year. At homebuilder **Toll Brothers**, where profits soared 57%, the formula used to determine the annual bonus for co-founder Robert Toll would have given him nearly \$50 million—a sum so huge that Toll and the board agreed to cut it by \$19 million, to \$30.4 million. Says Chief Financial Officer Joel Rassman: "It was a fairness issue."

While *BusinessWeek* isn't counting option exercises, those, too, were up last year, pay experts say. Rising equity prices allowed many execs with large stockpiles of options from previous years to cash them in. Howard Solomon, CEO of **Forest Laboratories**, collected a cool \$90 million. Not a bad haul.

—Louis Lavelle

THE BIG PICTURE

PAYDAY An early look at America's highest-paid CEOs

	2004 PAY \$MILLIONS	INCREASE OVER 2003
LEW FRANKFORT, COACH	\$58.4	+154%
RAY IRANI, OCCIDENTAL PETROLEUM	37.8	+31
ROBERT TOLL, TOLL BROTHERS	36.4	+52
BRUCE KARATZ, KB HOME	34.5	+27

Pay calculations include salary, bonus, and long-term compensation, including restricted stock and the Black-Scholes value of option grants.

Data: Standard & Poor's ExecuComp

MIGRATIONS

FANNIE MAY BE HIS NEW HOME

HAS WILLIAM McDONOUGH'S ardor for bean-counting waned? Two years ago, when the former banker became chairman of the newly created **Public Company Accounting Oversight Board**, he crowed to reporters: "I adore accounting theory." But after getting the auditing industry's new regulator up and running, the former **New York Federal Reserve** president is in the running to be **Fannie Mae's** next CEO, Washington insiders say.

Gossip about his itchy feet has circulated for months at



McDONOUGH He may be bored at PCAOB

the **SEC** which must approve a successor. One source says McDonough, 70, is bored at PCAOB, and notes he's no longer seen as a successor to the Fed's Alan Greenspan. A PCAOB spokeswoman says McDonough isn't talking to Fannie Mae.

Steering Fannie through three ongoing federal probes and a push by Congress for tougher oversight would be a challenge, but lucrative: Former Fannie CEO Franklin Raines' pay averaged more than \$2 million, vs. McDonough's \$595,000 annual salary. Also said

to be Fannie candidates: William Shea, former CEO of insurer **Conseco**, and former Senator Phil Gramm (R-Tex.).

—Amy Borrus, with Mike McNamee

STARSHIP WARS

BEAM ME UP It's a mission even Captain Kirk might balk at. Since Viacom's UPN network canceled in February what would have been the fifth season of *Star Trek: Enterprise*, Trekkies have been trying to save the show. **Tim Brazeal**, a 42-year-old tech worker, started **TrekUnited.com** to raise \$30 million to fund another season. So far he has \$3.1 million, including \$3 million from unidentified backers of the commercial space-flight industry. "*Star Trek* has inspired a lot of people," he says. "It's not just a TV show." The finale is May 13. But like the original series, the latest version will live. Viacom has sold the series into syndication beginning this fall.

—Christopher Palr

EMERALD ISLE

A DEEP POT OF GOLD IN IRELAND

THE "CELTIC TIGER" has joined a select group. Based on gross domestic product per person, Ireland is—along with Luxembourg, the U.S., Norway, and Switzerland—a "high income" country, says the **Organization for Economic Co-operation & Development**.

The OECD adjusts GDP for purchasing power to create a relative ranking. The study illuminates Ireland's recent economic surge since its entry into the European Union and investments in technology. GDP grew by nearly 10% a year from 1995 to 2000. So the Emerald Isle is in the green. —Brian Hindo

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FACE TIME

MICHAEL TRANGHESE



THE BIG EAST: DOES IT NEED A HAIL MARY?

March has been a mad month for Michael Tranghese, the Big East's commissioner. Just two of six Big East teams made it to the NCAA Tournament's Sweet Sixteen. Next year may be better, when five more strong basketball programs join the conference.

The basketball programs were lured by Tranghese after football powers Boston College, Miami, and Virginia Tech bolted the Big East for the Atlantic Coast Conference in 2003. That loss could hurt. Football is a large part of Big East revenues—\$68 million in 2003, the most recent year available. If its football teams falter, the Big East could lose its spot in the Bowl Championship Series, the six-conference cartel that divvies up lucrative bowl games.

Tranghese, 61, insists the Big East will do just fine. "We don't feel we're going to lose revenue on the bowl side." Why so confident? The former English teacher has 26 years at the Big East and has seen plenty of come-from-behind wins in his time. —Brian Hindo

THEME PARKS

FINALLY, THE YEAR OF THE MOUSE

THE GATES TO Walt Disney's newest Magic Kingdom—in Hong Kong—don't officially open until September, but people are already lining up. Since Feb. 15, when the park began taking reservations, Hong Kong Disneyland has accepted 10,000 bookings.

The \$1.8 billion park marks the kickoff of what CEO Robert Iger foresees as a new era for Disney in Asia. Talks are under way with the Chinese government about a second site, near Shanghai, by 2010. Seoul may also get a more modest Disney park.

With Disneyland Paris still in the red, why is Disney so confident about Asia? The park could benefit from the spread of family vacations among the Chinese as disposable incomes rise.

HONG KONG Disney opens in September

Trips abroad or even to Hong Kong were once

unheard of. Now, however, China expects to become the world's fourth-largest exporter of tourists by 2020, says the China National Tourism Administration. This trend, plus the country's 290 million children under 14 and its one-child policy, mean that "kids' vacations are where parents and grandparents are spending all their extra cash," says Zhang Shi, a marketing professor at the University of California at Los Angeles.

To reach these young people, Disney turned to 70 million-strong Communist Youth League create special programs for the group's "youth palace" that include storytelling sessions and visits from Disney characters.

Disney also learned from past mistakes. At Disneyland Paris, the lack of wine and beer, central to European family culture, caused publicity. In Hong Kong, buyers consulted a master of feng shui before completing plans. As bookings mount, Disney's betting it's not a small world after all.



GENDER WATCH

FINDING OUT HOW MUCH WOMEN EARN

THE BUREAU of Labor Statistics has unleashed an uproar with plans to stop collecting women's employment data in its monthly survey of employers. After nearly 5,000 com-

plaints, the BLS will ask for further public comment before substituting new questions about supervisor pay.

The BLS thought the data wouldn't be missed, since it gets similar info in its survey of households. But researchers at the **Federal Reserve** and elsewhere argue that the payroll data are more reliable.

The payroll survey measures the bottom 80% of the work force. Now the BLS wants to gather data on management jobs. With the new data it plans to publish an average pay figure for both groups. But that would paper over the widening gap between blue- and white-collar pay, says Heidi Hartmann, head of Washington's **Institute for Women's Policy Research**.

—Aaron Bernstein

THE STAT

4.6

The percentage of Americans who reported being victims of identity theft over the course of a year. Nearly 10 million people discovered their privacy had been compromised.

Data: 2003 Federal Trade Commission

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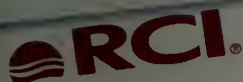


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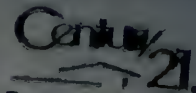


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A frivolous defense drives up litigation costs just as surely [as a frivolous lawsuit does].”

—Jonathon Moseley
 Legal Affairs Council
 Ashburn, Va.

TORT REFORM: SUGGESTIONS FROM FRONT-LINE COMBATANTS

I JUST READ “How to fix the tort system” (Special Report, Mar. 14) and wanted to commend you for a job well done. Other than perhaps being too skeptical about the cost that hyper-litigiousness exacts from our economy, I think your evenhanded piece provides a considerable service. I hope your four reform recommendations spark serious debate among policymakers. Follow-up coverage that may further compare our regulatory system to those of Japan, Germany, or other sclerotic, stagnating nations of Old Europe might be enhanced with brief mentions of their abysmal economic growth and unemployment rates. Socialist regulatory states are dying on the vine, and we ought not be looking to emulate them.

—Darren McKinney

National Association of Manufacturers
 Washington

YOUR SPECIAL REPORT should be required reading in law schools, law firms, and courtrooms, and, with crossed fingers, in the halls of Congress. I must warn you that this subject, usually presented in the first semester of law school, caught

my attention when the-then Tort Professor William Prosser, began to me with the catchy phrase, “No on really define a tort.” He then spent 1 pages doing so.

—Thomas R. Napton
 Merritt Island

WE WERE SURPRISED and disheartened to see our tort-cost estimates characterized as “misleading” (“In this debate, it’s by anecdote,” Special Report, Mar. 14). Tillinghast Towers Perrin’s tort-cost study is a respected, independent, and objective source of information. Our goal is to provide accurate data that informs the public debate, not to take a position on the pros and cons of tort reform. We have not changed our methodology in the 20 years we have published the study, nor do we accept outside funding for the study.

We do not believe that it’s possible to get a complete picture of the cost of the tort system by looking solely at data

BusinessWeek online A huge number of readers responded to our Mar. 14 Special Report, “How to Fix the Tort System.” For more letters on the debate, go to www.businessweek.com/extras.

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BusinessWeek

APRIL 4, 2005 (ISSN 0007-7135) • • •

3927

Published weekly, except for one week in January and one in August by The McGraw-Hill Companies, Inc. **FOUNDER:** James H. McGraw (1860-1948).

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Readers Report

the courts. Our study accumulates all of the costs of damages awarded to injured parties as a result of the negligence of others, including the costs that are embedded in the liability-insurance system and the claims that are settled out of court.

We agree that an accurate segregation of costs between legitimate claims vs. "junk lawsuits," class-action abuses, or runaway jury awards, would be critically important to the policy debate. However, we have found no way to accomplish this segregation with available data.

—Stephen Lowe
Managing Director
Towers Perrin
Weatogue, Conn.

ONE OF YOUR proposals is problematic: Punishing lawyers who file frivolous lawsuits cannot work absent an objective definition of "frivolous." Wait until some judge dismisses your lawsuit because the judge favors the opposing attorney as a local regular. A judge in Arlington, Va., was caught not even opening 12 to 15 pleadings from their envelopes. To a defendant intent on cheating you out of your money, your lawsuit is "frivolous."

Such a proposal must also punish frivolous defenses. Refusing to pay you, your ex-employer has its attorney file bogus and deceitful defenses rather than pay what is owed you. A frivolous defense drives up litigation costs just as surely.

—Jonathon Moseley
Executive Director
Legal Affairs Council
Ashburn, Va.

YOUR ARTICLE "HOW to fix the tort system" is excellent. I agree with much, but not everything, you propose. In particular, I do not think you're justified in taking some cases out of the court system. Absent a far more compelling case, we must keep the courthouse doors open—and preserve access to justice—for all. We don't pledge allegiance to liberty and justice "for some."

I was also struck by three ways in which you strayed from your otherwise scrupulously evenhanded approach. First, you correctly noted that the debate over our court system is a "war by anecdote" where almost every figure used is "misleading" because "there aren't any good numbers to go on," but sometimes you made this mistake yourselves. Second, you often focused on one side of the adversary system and not the other.

Finally, you failed to take into account the different incentives in place for plaintiffs' lawyers paid on a contingency basis

(i.e., only if they win) and corporate defense lawyers paid by the hour. Both logic and basic economic theory suggest that the former will be far less likely to waste their and the courts' time on frivolous matters than the latter.

—Arthur Bryant
Executive Director
Trial Lawyers for Public Justice
Washington

AS PRESIDENT (now retired) of a small business with sales of less than \$1 million, we were sued three times, and each time we settled out of court. Even though our lawyer said we could win if we went to trial, in each case it would have cost us a minimum of \$20,000. From my experiences and those of others in similar situations, a very large number of cases are settled out of court—at close to the cost of going to trial. That is a large drain on a small business.

—Richard Kahle
Arlington, Tex.

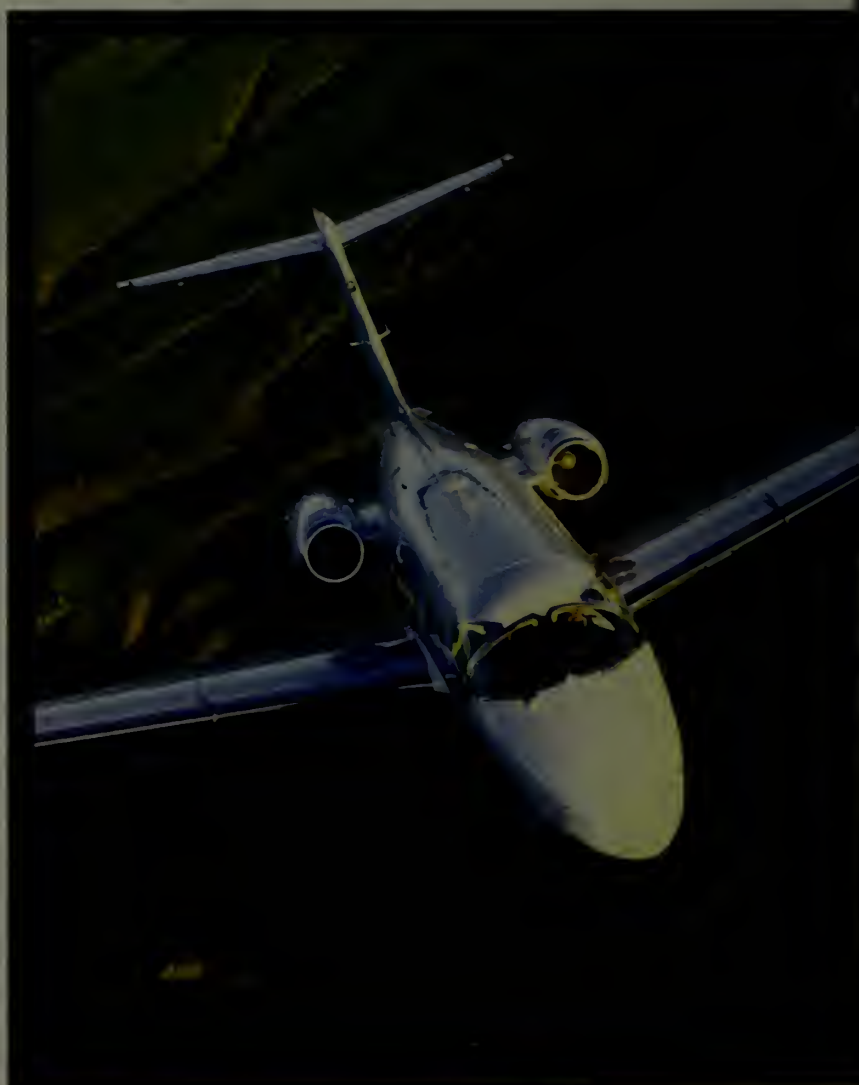
AS A PROFESSOR of business law, I routinely discuss the tort system in America by using articles from various publications,

yours included. In most articles I find any real discussion of the rights of innocent victims. The vast majority of tort cases are valid. Juries are generally too slow to award millions to undeserving plaintiffs and attorneys cannot make a living by dwelling trivial or losing lawsuits. Check the percentage of winning plaintiffs in medical-malpractice cases in Georgia; you will find that it is only about 5%. Litigants should be wary of severely limiting the rights of deserving victims in an attempt to root out a few bad apples.

—S. Alan
Kennesaw State University
Kennesaw, Ga.

THANK YOU FOR a rare rational discussion of tort reform. Aside from the billion-dollar addition to the cost of health care, the insurance problem is lack of predictability, particularly at the high end, which is needed to accurately set premiums. Actuaries can fairly accurately forecast claims frequency. They are also pretty good with actual damages.

They cannot, however, accurately predict noneconomic damages, which are



ed consistently. The higher the the less predictable it becomes. The ial trend line for cases up to 000 is pretty straight. At \$1 million it e jagged and steeper. At \$2 million it y and steeper yet. To be able to pay s, an insurer must set premiums high h and carry enough capital to cover peaks. Caps modulate these spikes mprove predictability, allowing for premiums. Your suggestion of a schedule for various types of injuries, Europe, would also improve pre- ability and is worth investigating.

—G. Richard Geier, M.D.
Chairman
Midwest Medical Insurance Co.
Rochester, Minn.

MAJOR FLAW in our legal system's ach to medical malpractice is its in- y to distinguish bad outcomes that because of substandard medical care ones that occur despite good care. A mark Harvard study found that only of patients who won malpractice suits suffered injuries as a result of negli- e. While you are dismissive of special

health courts with "dedicated judges, a panel of neutral experts, and medically trained staff," changes of this sort are necessary for the sake of justice.

—Dory Altmann
East Brunswick, N.J.

AS AN OB/GYN in Pittsburgh for the past 20 years I have witnessed firsthand the change in my specialty wrought by the medical-malpractice crisis. Once physi- cians would discuss difficult or rewarding cases. Now all we ever talk about is liabil- ity reform and who has left the state for a better working environment. With only 4% of the physicians in private practice in Pennsylvania under age 35, I worry for the people of our commonwealth once the baby boomer physicians start to retire.

Mike France's piece on the tort system is the best piece of reporting I have seen. Traditionally, physicians were never as politically active as attorneys, giving much less to political action committees. But we are starting to learn how to play the game. Many states, such as Indiana and California, have already adopted re- form with good results. I welcome a na-

tional debate on the subject, devoid of hyperbole. Sadly, that is unlikely to happen.

—John Fisch M.D.
Monroeville, Pa.

A NEW LEASE ON LIFE BY STIMULATING THE VAGUS NERVE

I ENJOYED WITH particular interest "Rewiring the body" (Cover Story, Mar. 7). I was a study patient in Cyberonics' in- vestigational clinical trial of vagus nerve stimulation and depression. I testified at the Food & Drug Administration's Med- ical Devices Panel meeting. Vagus nerve stimulation completely changed my life— from severely and chronically depressed to a completely normal life.

I am ever so grateful.

—Charles E. Donovan III
St. Louis

Editor's note: The writer is the author of *Out of the Black Hole: The Patient's Guide to Vagus Nerve Stimulation & Depression*.

THOSE '70s SOUNDS BARKER LIKED ARE MUZAK

WE'RE HAPPY THAT Robert Barker en- joyed the '70s sounds of Carole King and Brothers Johnson ("instead of Muzak") at Whole Foods Market ("What could take a bite out of Whole Foods," The Barker Portfolio, Mar. 14). Barker may be sur- prised to learn that the music that made him feel so good is in fact supplied by Muzak. We create Audio Architecture ex- periences for hundreds of leading retail, food-service, and hospitality brands. The program he was listening to was '70s Hits, designed by Smitty, one of our more popular Muzak Audio Architects.

—Sumter Cox
Muzak
Fort Mill, S.C.

Editor's note: We regret the error.

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Biotech's Fountain of Youth

MORE THAN HUMAN Embracing the Promise of Biological Enhancement

By Ramez Naam; Broadway; 276pp; \$24.95

Imagine what your life would be like if a surgeon planted a computer chip in your brain that instantly made you smarter, more productive, and more sexually dynamic. And if you popped a pill every day that slowed the deterioration of your body's cells, all but assuring that you would live to be 160. Want to get tan

without having to bask in cancer-causing sun rays? No problem: A simple injection would alter your genes, giving you the L.A. look you always wanted.

This is the world brought vividly to life in *More Than Human: Embracing the Promise of Biological Enhancement* by Ramez Naam. The first-time author takes readers on a fascinating tour of biotech experiments that could someday bring benefits we would barely recognize as medical. Naam describes how healthy people might use these same biotech drugs and devices to help them live longer, happier, richer lives. He boldly argues that lawmakers should not try to block this trend on ethical or religious grounds but rather embrace it as a boon to the economy.

Naam, a computer scientist for Microsoft Corp. and a regular on the biotech lecture circuit, offers little discussion of the physical dangers or social perils of biotech enhancement. Still, this well-researched treatise provides a compelling glimpse of what life could be like if biotech treatments become as common as vitamins.

The most interesting characters in *More Than Human* are the lab creatures scientists are using to try to figure out how to extend human life. At the University of Connecticut, researchers accidentally discovered that a variant of a gene doubles fruit flies' life span. Such flies process the food they eat inefficiently, putting them in a natural state of "caloric restriction" that, scientists believe, may slow cell damage and extend life. Several companies are working on drugs that would mimic this effect in humans without the need for semi-starvation. Naam's beguiling—if wide-eyed—conclusion is that someday a drug will "cure" old age.

Life-extension pills won't hit the market anytime soon, but some of the other possibilities Naam describes seem more plausible. He predicts, for instance, that gene therapy could replace such biotech drugs as erythropoietin (EPO), a molecule that increases the production of red blood cells to treat anemia. Some elite athletes currently use EPO to boost stamina, though that treatment requires frequent injections. If current work in gene therapy were to pan out, ordinary

people—even weekend warriors who just want to improve their tennis games—might be able to get a single gene-altering injection that would cause their bodies to make red blood cells naturally for the rest of their lives.

This scenario terrifies lawmakers who are trying to get EPO, steroids, and other illicit drugs out of sports. Because gene therapy would mimic the body's natural processes, an existing drug test would nab athletes who cheat. Naam argues that the solution to the debate over drugs in sports is to stop treating biological enhancement as a crime. Instead, he says, everyone should be given tools such as gene therapy to make themselves stronger and faster.

Naam glosses over a few considerations, especially safety. The author does remind readers that at least one patient receiving experimental gene therapy has died. But he does not dwell over such examples so quickly that readers may come away believing these treatments are ready for prime time. In fact, it could be decades before they can be made safe and effective.

Naam's economic arguments seem more convincing. He believes that smarter, healthier people would be more productive, and, as he points out, even a 1% increase in productivity adds \$1 billion to the U.S. economy. One flaw in this scenario is that not everyone would be able to afford biological enhancement. The cost of such treatments would result in a dangerously stratified world, with only those able to shell out big bucks to build muscle or boost their intelligence getting an unfair advantage at the best things in life.

Naam counters that the prices of all new biotech products eventually fall. He believes, for example, that some of today's most expensive biotech drugs are poised to go generic, since their patents are about to expire. But in fact, manufacturing and regulatory obstacles could delay generic biotech drugs indefinitely. Meanwhile, a great many people are already struggling with health-care costs. Recent studies say medical debt is the cause of at least half of U.S. bankruptcies. So radical biotech

enhancements will likely remain out of reach for healthy, middle-income people.

As experimental treatments come closer to reality, debates over the science, ethics, and economics of biotech-enhanced bodies will grow ever more heated. Whether for good or ill, at least some of the interventions Naam describes are inevitable. That makes the trip through his biologically enriched world all the more provocative—and edifying.

—By Arlene Wein



A faster, smarter, stronger future—for those who can pay

rief

ad for Virgin Territory

CEAN STRATEGY

Create Uncontested Market Space and Make the Competition Irrelevant

W. Chan Kim and Renée Mauborgne;
Harvard Business School Press; 240pp; \$27.95

Successful businesses, from multinationals with thousands of employees to neighborhood eateries, are often based on the idea of filling an unmet need. A variety of new products and services, however, are copied by competitors or category leaders, with the result that most of them fail. As the authors of *Blue Ocean Strategy* put it, these businesses are just jumping into "the red ocean of competition." Instead, authors W. Chan Kim and Renée Mauborgne recommend seeking new waters—virgin territory devoid of me-too propositions and cutthroat pricing. An archetype: the Japanese car company, which based its business model on a cup of coffee priced two to four times what others charged, but sold it in an appealing environment. The authors, both of whom teach at business school near Paris, are at their best when offering less well-known examples gathered from around the world. For example, Mexican cement manufacturer Cemex' business took

off in 1998 when, unbelievably enough, it successfully positioned bags of cement as an appropriate wedding "gift of dreams"—the ingredient necessary to add a room onto a house. In 1993, Hungarian bus maker NABI turned the \$1-billion-a-year U.S. municipal-bus industry on its head by building lighter-weight, cheaper-to-maintain fiberglass vehicles. Instead of competing with established steel bus makers on sticker price, NABI appealed to city purchasers with the lower long-term repair and fuel costs of NABI buses.



The authors deal with more familiar examples as well. Yet these, too, seem fresh when offered in the context of the blue-ocean idea. Even readers who care little about the circus, for example, will appreciate learning how Montreal-based Cirque du Soleil became a smashing financial and critical success. Eschewing Ringling Bros.-like animals, sawdust, and three-ring format, Cirque du Soleil put together a unique—and much lower-cost—blend of music, clowns, acrobats, and theater. Curves—the gym-franchise phenomenon that appeals to many women who feel uncomfortable in traditional health clubs—is examined for its common-sense approach to finding out what customers really want.

Such stories support the authors' business-planning advice. Kim and Mauborgne avoid excessive charting and diagramming of brand attributes, but those they do include are genuinely helpful. *Blue Ocean Strategy* will have you wondering why companies need so much persuasion to stay out of shark-infested waters.

—By David Kiley

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BY STEPHEN H. WILDSTROM

The PlayStation Portable Has Miles to Go

The new Sony PlayStation Portable is a brilliant portable game player with multimedia aspirations. It also manages to collect in one product the contradictions that cause frustration for Sony customers these days and indicate why new CEO Howard Stringer will have his hands full restoring Sony to its past consumer electronics glory.

There are many things to like about the \$250 PSP. To start with, it has an attractive design and a shiny black case. It weighs just 10 oz. and sports an outstanding 4.3-in. widescreen display. As a portable game console, it sets a new standard for excellence. Its superb 3-D graphics deliver smooth images in even the fastest-action sequences, and its controls are sure and

responsive. Given that the PSP is in the PlayStation family, the availability of games, starting at \$40, should be very good.

The PSP is also a fine movie player—with a catch. The video is as good as I have seen on any portable device. And, as in games, the stereo sound (through earphones) is great. Battery life for games or movies runs up to about five hours. The frustrating part is that the PSP can play movies only from a sort of mini-DVD disk in a proprietary design that Sony calls a Universal Media Disc (UMD). Only a handful of titles, mostly action films such as Sony Pictures' *Spider-Man 2*, are available initially—at \$20 a pop—and it's far from clear whether studios will embrace the format. Sony has no plans to offer recordable UMDs, and since the PSP has no hard drive, you're stuck with what is available prerecorded. You can download your own video clips to the memory card, but the capacity is very limited.

THE PSP ALSO INCLUDES WI-FI wireless networking. That means it can connect to nearby PSPs for multiplayer games or to the Internet to obtain software updates or for access to Sony's online gaming service. But it doesn't let you enjoy streaming video or music over Wi-Fi. And the new consoles do not support the best current wireless security standard, Wi-Fi Protected Access, so you will have to relax security on your home network if you want to take full advantage of it.

The PSP also suffers from a problem inherent in multifunction devices. Its specialized design as a game console makes it awkward for other uses. For example, gamers understand the function of the circle, cross, square, and triangle buttons, but their function in, say, controlling the a movie playback, is obscure at best.



A first-rate game console falls short as a video and music player

design—that includes Sony's MagicGate copy protection.

Fortunately, most of the PSP's worst deficiencies are in software and could be remedied, even on existing units, if Sony chose to take action. It could, for example, add software to allow music transfers from a computer and permit support for standard formats, such as Windows Media. The PSP would be more useful if the Wi-Fi connection could be used to play online audio and video content—and not just what Sony chooses to provide.

This will, however, require some attitude adjustment by Sony. Standards rather than proprietary technologies are growing more and more important in a networked world. Sony's continuing insistence on doing everything the Sony way leads only to isolation. ■

E-mail: techandyou@businessweek.com

Sony has made much of the PSP's music-player abilities. But three years into the iPod era, it's amazing that the company got it so wrong. There's no concept of automatic sync, standard on other players for loading songs. Instead, you must find the music on your computer. Then you copy them onto the PSP's Memory Stick memory card, either by inserting

the card in a PC adapter or by connecting a USB cable between the PSP and the computer and manually putting the PSP into USB mode.

The PSP supports only MP3 and Sony's own ATRAC format, so the only purchased music it can play is songs from Sony Connect music service. Even then, purchased music must be stored on a special type of Memory Stick—another Sony

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BY ROBERT J. BARRO

Why Private Accounts Are Bad Public Policy

I once thought personal accounts for Social Security were a good idea but have changed my mind. Personal accounts have some virtues, but the common arguments, both pro and con, are myths. Overall the accounts are a bad idea. ¶ The strongest points for personal accounts involve property rights and the freedom of choice. When people contribute to a personal

account, property rights insulate benefits from future Congresses who can change the program as they wish. The rights also mean that, unlike the current program, the contributions are not a tax that discourages work. Personal accounts also allow for differing preferences on which assets to hold, how much risk to take, and when to receive income. Forcing everyone into a one-size-fits-all plan is usually unwise.

Advocates of personal accounts cite the low rates of return in the current system, but this is misleading. Prospective returns to young people are low mostly because we gave benefits to older generations of retirees who did not contribute their share of taxes to pay for them. One way or another, the burden of this generosity has to be borne by the young. From the perspective of the trust fund, returns look low because the fund's government bonds have paid less than stocks. But the premium on stocks is compensation for risk, as gauged by financial markets. Although the ability to hold stocks is a plus, there is no free lunch of assured higher returns.

Another myth is that these accounts enhance saving and economic growth. In fact, tinkering with Social Security won't have major effects on national saving, investment, or growth.

An opposing myth is that the transition requires too much government borrowing. In fact, a debt-financed transition entails substitution of explicit liabilities (government bonds) for unfunded liabilities (future benefits in the present system). There are no substantial effects on interest rates, national saving, and the current-account imbalance.

A SERIOUS ANALYSIS STARTS with asking why we have Social Security. If we were not so used to it, we would find it odd for the government to collect money from young workers and give it to the old (mostly workers' parents). One rationale is that the government should help people who lack discipline to save for old age. I have never embraced this paternalistic view. It's true that society will inevitably provide welfare to the needy elderly. Knowing this, some people will save too little and rely on public support when old. Thus, there is reason to require workers to save for retirement. How much depends on what is viewed as a minimal standard of living; suppose it is \$1,000 per person per month. (Currently, a person with the median earnings history gets \$1,200 from Social Security.)

Contributions that fund just the minimum cannot go into a meaningful personal account. People would opt for too much risk, knowing they would be bailed out if they fell short. Contributions that cover the minimum provide no individual return and, therefore, amount to a tax that discourages work.

Personal accounts have to supplement the minimum payout. But then why have a public program at all, rather than relying on individual choices on saving? I think there is no good reason to go beyond the minimum standard; that's why I view personal accounts as a mistake—they enlarge the Social Security program that already promises too much.

To provide an acceptable standard of living, baseline Social Security benefits should be indexed to prices. The practice

Social Security promises too much now. So why enlarge it?

indexing initial benefits to past wages should be eliminated. Moreover, the price index should be an accurate one, such as the Bureau of Labor Statistics' chain-weighted consumer price index, rather than the standard flawed index. In addition, the normal retirement age should effectively be indexed for changes in life expectancy, going beyond the current plan to raise the age to 70. These three adjustments are all important. Together, they more

than suffice to "save" the current Social Security program.

A mistake even greater than personal accounts would be, in addition, to raise the maximum earnings taxed by Social Security above the current \$90,000, a proposal that President Bush seems to welcome. This change increases marginal tax rates by about 10 percentage points on a productive group that already faces high marginal rates. Not a good idea for economic growth. President George W. Bush should remember the line, "Read my lips—no new taxes," and take it more seriously than his father did. ■

Robert J. Barro is a professor of economics at Harvard University and a senior fellow of the Hoover Institution (rjbweek@harvard.edu).

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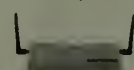
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JAMES C. COOPER & KATHLEEN MADIGAN

Inflation Is Back On the Fed's Radar

With demand rising, businesses are finally able to pass along higher costs

U.S. ECONOMY Think of easy access to financial resources as the tinder that can set an economy on fire. Whether it's from easy bank credit or mortgage refinancings, more valuable equity, or cash coming from rising profits, money generates a lot of heat. Right now financial conditions are extremely accommodative. Not surprisingly, the U.S.

economy is simmering along nicely, as consumers and businesses boost their spending.

One result of solid growth is that inflationary pressures are building as businesses face rising costs. At the same time, the falling dollar is making imports more expensive and oil prices are up sharply. The question is: How fast must the Federal Reserve raise interest rates to make sure that demand doesn't overheat, allowing rising costs to pass through into faster consumer inflation? For the first time in years, inflation is officially back on the Fed's radar. In addition to another quarter-point hike in the overnight federal funds rate to 2.75% on Mar. 22, the Fed stated that "pressures on inflation have picked up over recent months and pricing power is more evident." This admission sent the bond market reeling. The 10-year Treasury yield jumped from 4.47% before the announcement to close at a nine-month high of 4.64%. The comment set a decidedly more hawkish tone, even though the Fed held to its belief that rates can continue to be raised at "a pace that is likely to be measured."

Such a stance, while highlighting the Fed's recognition of inflation, appears somewhat contradictory. One plausible explanation is that policymakers view the recent uptick in inflation as temporary. Another possibility: The move was a compromise between the inflation hawks and doves in order to avoid a split vote. The minutes of the meeting to be released on Apr. 12 should shed some light on the rationale.

One thing is clear: The Fed's new emphasis on inflation provides a litmus test for more aggressive policy moves. If pricing power continues to accelerate, then the Fed may have to hike the funds rate in half-point steps. Unless financial conditions are cooled off soon, strong growth and will continue to use up whatever slack is left in the labor markets and production capacity.

WHAT'S WHY THE NEWEST DEVELOPMENT in the economic outlook cannot be taken lightly: Cost pressures on U.S. businesses are rising at a pace not seen in many years. And those pressures are coming at a time when the factors that held back inflation in the late 1990s—a restrictive Fed, rapid productivity growth, and a strong dollar—have all changed direction and thus are exerting

less resistance. Moreover, with overall demand, both in the U.S. and globally, growing hotter by several degrees during the past year, many businesses are having greater success in passing their higher costs along to their customers. So far, the pass-through effect is showing up mostly at the producer level. However, evidence of upward pressure on consumer prices is becoming more noticeable as well.

RIISING PRESSURE ON GOODS PRICES



the Fed has to lift interest rates in order to make policy less accommodative. That's because it is real, or inflation-adjusted, interest rates that determine how restrictive policy is.

THE COST SQUEEZE began with this year's round of increases in commodity prices generally and oil in particular. These price hikes are clearly feeding through the production pipeline. Through February, prices of core semi-finished goods, which exclude energy and food items, were rising at a yearly pace of more than 8%, a rate not seen in two decades. Further up the line, the yearly inflation rate for core finished goods has accelerated to 2.8%, the fastest pace since 1992.

And it's not just costlier materials that are squeezing business budgets. With productivity slowing down, unit labor costs have risen over the past three quarters at the fastest annual rate in almost four years, even though compensation growth has not yet begun to pick up.

The loss of past inflation restraints is showing up most clearly in goods prices (chart). That's because low interest rates and rising materials costs have a big impact on

goods demand and output. Plus, the prices of nonoil imported goods are rising. In February they were up 2.9% from a year ago, a percentage point faster than last year at this time. This acceleration has given domestic manufacturers some room to raise their own prices. So it's not surprising to see that over the past year the inflation rate for core consumer goods has gone up in lockstep with higher import prices and the increase in producer prices.

These latest trends ignore the impact of oil and gasoline prices, which will begin to show up in the March and April price indexes. Reflecting the surge in crude oil to more than \$55 per barrel, the national average price for regular unleaded gasoline hit a record \$2.11 on Mar. 21, up 10.7% in just the past four weeks (chart).

To the extent that improving labor markets will keep demand strong, businesses will find it easier to pass along their higher energy costs into prices of their own products. The Fed's Mar. 22 statement said that costlier energy "has not notably fed through to core consumer prices." That means this summer, the Fed will be watching closely for any broader inflation impact.

WHAT CAN PREVENT the inflation cycle from feeding on itself? The wedge may have to come from the Fed itself, with broader removal of liquidity from the economy to blunt any rise in inflation expectations. That's why monetary policy, while always important to the outlook, is now even more crucial to maintaining the health of this expansion.

That's especially true because, up until Mar. 22, the bond market had not reacted in typical fashion to the Fed's rate hikes. In mid-March, bond yields were lower than they were last June when the Fed began its series of increases. Now, they are about even, sustaining the relatively cushy financial conditions that are stimulating growth.

Take housing and consumer spending. Because mortgage rates are hovering near 6%, buyers still have less to bid up home prices. Rising real estate values have pumped up household wealth, leading to more consumer spending. Cheap mortgages enable homeowners to tap in



housing wealth through refinancings and home-equity loans. Mortgage rates would have to rise by a substantial amount, probably hitting close to 7%, before consumers stop using their homes to finance current spending.

To the Fed's credit, its latest policy statement accomplished what past rate hikes did not: It lifted long-term rates significantly. Higher borrowing costs at the long end will help to achieve the goal of tamping down the financial fires. Given the upward trend in pricing, the Fed clearly has more work to do. Perhaps a lot more.

JAPAN

Land of the Slowly Rising Economy

THERE'S A HINT of improvement in Japan's economy. Revised data show growth in last year's fourth quarter, rather than a third consecutive contraction, and the latest monthly reports suggest the economy is gaining momentum in early 2005.

The government's second estimate of fourth-quarter real gross domestic product shows the economy grew at a 0.5% annual rate instead of shrinking 0.5% as originally reported. The revision reflected a faster pace of inventory growth, a positive sign for industrial production in coming months.

The stockbuilding in industrial supplies and intermediate goods, a sign of improved demand for final products. Indeed,

industrial production began the year with a 2.5% surge from December, the largest advance in nine months, and current industry projections imply a solid gain for the quarter, the first in nearly a year.

More important, the outlook for consumer spending is improving. Outlays by salaried workers' households jumped 8.2% in January, the best gain in nine months, and

stronger job markets bode well for future demand. Employment soared by 470,000 in January, the biggest increase since 1992. Although the labor force grew by even more, resulting in a rise in unemployed workers, the jobless rate remained at a six-year low of 4.5%. Plus, the GDP data

now show that workers' incomes rose 0.7% from a year earlier. That's a small rise, but the first in a year and a half, boosted by larger bonuses.

In addition, the mix of job gains is improving, suggesting the structural shift toward cheaper, part-time workers is winding down, as companies gain confidence in the future. In the past year, the growth in part-time jobs has slowed sharply, while in January full-time positions increased 0.8% from a year ago, the first rise since 1997.

To be sure, Japan's road to recovery remains bumpy. A potential pothole this year could be the rising cost of raw materials, especially oil, which threatens to depress profits and capital spending, as well as export demand. However, given the positive surprises so far in 2005, the economy appears to be on much firmer ground now than it was this time last year.

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It will be flat, ultra high-tech, and made in Asia. Now, Americans want a piece of the action.

BY BRUCE EINHORN

EVERY DAY THOUSANDS OF liquid-crystal and plasma displays are shipped from factories owned by Samsung, Matsushita, Sharp, Pioneer, LG, and five Taiwanese companies. These are some of the world's top suppliers of the elegant, thin televisions that are streaming into homes everywhere. The Asians have committed \$35 billion to flat-panel capacity in 2004 and 2005. And as TV makers place their bets, legions of glass, semiconductor, and other parts suppliers are revving up their production.

Sounds like another Asian juggernaut in the making—but not if Michael S. Dell has anything to say about it. The surge in investment and proliferation of suppliers has driven flat-

panel prices down to levels unthinkable two or three years ago. That has opened the door to a set of rivals the Asians never expected to face: first and foremost, Dell Inc., and, to a lesser extent, Hewlett-Packard Co. These and others in North America are making a concerted push into flat TVs, sourcing the panels from Asia and using the same global supply-chain wizardry they have employed so effectively in PCs, printers, and other products. For now, there are no signs that the mass production of giant flat panels will migrate to North America. Still, the American TV industry may be poised for a startling resurrection. “We’re going to raise people’s eyebrows this year,” vows Gerry Smith, Dell’s Singapore-based vice-president and general manager for displays. “We are going to be successful in this market.”

Dell’s low cost structure, peerless supply chain, and direct-sales model lets it drastically undercut rivals’ prices. Last fall

SHARP LCDs So far, Sharp, Sony, and Samsung offer some of the best designs

MICHAEL CARONNA/BLOOMBERG NEWS

it introduced high-definition 42-inch plasma sets for less than \$3,000, with incentives, while Sony Corp. and others were selling similar models for more than \$4,000. In a matter of months, Dell seized 10% of this important slice of the plasma market in the U.S., says researcher DisplaySearch in Austin, Tex. The Asians dropped their prices quickly in response. But Dell intends to keep up the pressure.

The return of American TV brands sets the stage for an epic battle between the forces of commoditization and manufacturing innovation. In the first camp, Dell and HP are already two of the world's biggest buyers of flat-panel monitors, semiconductors, and other parts for PCs, so they have great leverage over the same Asian suppliers when it comes to sourcing thin screens for televisions. In the innovation camp, Japanese, Korean, and Taiwanese companies will spend almost any sum to dominate flat-panel TV production. With their prowess in manufacturing, they gain an edge in design, engineering, and product innovation that the Americans may have trouble matching.

"THE CHANCE OF A LIFETIME"

THE SPEED AND MAGNITUDE of these mostly Asian investments is without precedent in the history of television. A Seoul-based joint venture owned by LG Electronics and Royal Philips Electronics is spending \$5.1 billion to create the world's largest factory for liquid-crystal displays. Sony and Samsung are teaming up in a \$2 billion LCD venture. AU Optronics Corp., partly owned by Taiwan's BenQ Corp., just started production at a new \$2.5 billion complex big enough to house six Airbus A380 jumbo jets. Matsushita Electric Industrial Co., which has spent billions to ramp up in plasma screens, is sinking \$1.3 billion more into a new plant just to provide the chips for thin TVs. "This is the chance of a lifetime," says Fumio Ohtsubo, a senior managing director at Matsushita. "Companies that lose out now will find it very difficult to recover."

Over time companies that dominate the new TV market could take home unimaginable wealth. Last year flat-panel makers earned a combined \$8 billion in profits, estimates DisplaySearch President Ross Young. They promptly poured so much back into their factories that LCD makers alone are in a position to crank out 140 million LCD TV panels a year by 2007, while still meeting de-



mand for all other applications. That's enough to supply two-thirds of total global demand for TVs in that year—if all those consumers made the switch.

This thrust into flat TVs won't be a replay of the 1960s and 1970s, when Sony, Matsushita, and other Japanese companies filled the world's living rooms with color televisions, driving American pioneers and most European makers out of the market. This time many more companies are producing key components—and China is eager to join the fray.

Thanks in part to the arrival of all these commodity players, the flat-panel TV industry has already gone through its first bout of overcapacity and consolidation. Prices on 32-inch LCD TV panels are 44% cheaper than they were in the first quarter of last year, and they could drop 20% more in the year ahead, according to DisplaySearch. The Asians are feeling the

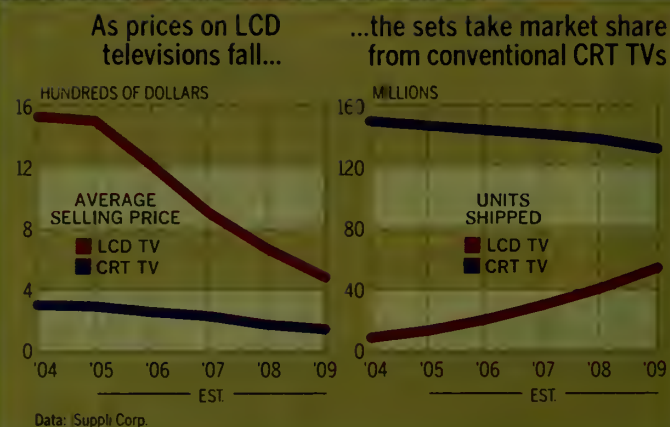
pain. One example: Samsung's fourth-quarter profits from high-end displays dropped 99%, to about \$7 million.

It's not the first time Asian makers seen wild swings like this in high-tech. Heavy capital spending followed by downturns and droughts are typical of the commodity chip industry that Asians have come to dominate. And, just as many Japanese players exited the memory-chip market when the competition got too hot, display makers are dropping out. In January, Hitachi, Toshiba, and Matsushita pooled their efforts in high-end LCD panels the sort used in TVs. Japan's Epson and Sanyo have joined forces, too. And Fujitsu Ltd. plans to reduce its stake in a joint venture in plasma displays.

Enter the Americans. For years, companies have talked about the convergence of consumer electronics and computing. Apple Computer Inc. quickly scored a home run with its creative iPod franchise. But big computer companies rarely just watched from the sidelines, in part because of flat-panel prices.

Now, with a global glut of flat panels, PC companies such as Dell can draw on some real advantages. Teams of Dell engineers can co-develop branded TVs with flat-panel engineers from Asian panel suppliers, several of which are now house units of rival TV makers. Traditional TV makers say consumers will want to compare TVs in a store before buying.

A FLAT SCREEN IN EVERY HOME?



ts once made the same
ctions about PCs. "The
V market, like the PC
et, is moving to stan-
technologies, best
, and more commoditi-
n. We do that very
" says John Hamlin,
s senior vice-president
e U.S. consumer busi-
And for shoppers who
they must see a TV in
n before handing over
dit card, Dell has set up
ks in U.S. shopping
s to display its line of
TVs. Even some Japan-
concede that commodi-
ion favors the Ameri-

. As long as it stays focused on a
ow range of products, "Dell may actu-
have a chance to succeed," says Fujit-
hairman Naoyuki Akikusa.

DDBYE TO THE PC?

S HOPING to put its supply chain to
k, too. In January, at the consumer
ronics show in Las Vegas, the com-
y announced a range of plasma and
television, and Shane V. Robison,
utive vice-president and chief tech-
gy officer, insists HP will be able to
ver low-cost models. "Volume mat-
, and we have a \$50 billion purchas-
engine," he notes. That means com-
ies that make the panels for PCs and
must come to HP with their best de-
s, at the best price.
Asian TV makers have already mapped
a response to commoditization and

the Dell effect. For at least the next year, they figure, much of the flat-TV business will still go to top-tier Asian makers such as Sony, Sharp, and Samsung, which offer some of the most appealing designs. The new models "are like clothing and fashion," says Takuji Okawara, general manager of the division at Sharp Corp. that oversees the company's TV designs. Choi Gee Sung, president for digital media at Samsung Electronics, says design will be "a differentiating factor."

To avoid seeing their products commoditized by Dell and other newcomers, traditional TV makers are also trying to steer viewing habits in new directions. Their success will depend on how well they utilize the digital capabilities of the new televisions. Over the next three years

KOREA VS.

THE U.S. Falling LCD prices have hurt Samsung and eased Dell's entry into the TV market

the next three years

users can shuffle content from one set to another, also without involving a PC. Ultimately, according to this strategy, the desktop PC becomes unnecessary because "everything will be connected through the TV," says Makoto Kogure, president of Sony's TV group.

The compelling part of this strategy is that it confronts the competition—Dell and HP—with a classic innovator's dilemma. Both are capable of positioning their new TVs as replacements for home PCs. But they're unlikely to do so if it undercuts their successful PC products.

The unpersuasive part is that the idea of a do-everything television isn't new and has never won many fans. Other than for game consoles that plug into TVs, not one crossover scheme has ever caught on. Meanwhile, there's a long list of reasons most people don't want their TVs to converge with their computers, starting with crashes and viruses and ending with the simple fact that computers remind people of work.

As American and Asian players circle each other, component makers with the most distinctive technologies stand to profit. Chip-maker Texas Instruments Inc. sells semiconductors used in one of the most popular approaches to flat TVs, a rear-projection system based on TI's digital light-processing (DLP) chips. Such TVs are available in more than 50 brands, including Toshiba, Mitsubishi, Panasonic, Samsung, and RCA. A host of lesser-known chip design-

ers, such as Silicon Valley-based Zoran Corp., hope to cash in on demand for chips that make flat panels more versatile.

Then there's high-tech glass. America's Corning Inc. has over 50% of the market for flat-panel glass and expects to spend \$1.8 billion to expand capacity in the three-year period ending in 2007, primarily in Asia. James B. Flaws, Corning's vice-chairman and chief financial officer, predicts that flat panels could account for 20% of TVs sold around the world by 2007. For that to happen, he concedes, TV makers must push flat-TV prices down to the point where they are only 50% more expensive than CRT models. That means accepting lower prices for glass, too, but Corning says lower manufacturing costs and higher volumes should offset that.

China could play a major role in reaching these lower price levels. But much



millions of U.S. homes will upgrade their video systems to digital formats, including high-definition television. Many of these sets, including flat-panel models, are designed to work with Microsoft Corp.'s Media Center PCs, which run all the usual suites of PC programs and also let the user control audio and video gear from the computer.

Asian setmakers aren't trying to avoid the Media Center phenomenon. But many have their own strategies for the digital living room. Sets from Samsung, among others, will let viewers insert a card that contains their photo and music collections into a TV and then organize them through easy-to-follow menus on the screen without ever having to boot up a PC. Several companies are building digital video recorders right into their sets, and they may also embed Wi-Fi links so

hinges on how long it takes Chinese companies to master complex flat-panel manufacturing processes. For now the Chinese aren't much of a threat. "Unless we give the Chinese the technology, they can't catch up," says Yasuo Sakuma, general manager for plasma product planning at Pioneer. But China's BOE Technology Group, which took over the LCD business of Korea's Hynix Semiconductor Inc. in 2003, will start making LCD TV panels later this year. And TCL Corp., China's No. 1 TV maker, also wants to produce key components rather than buying them from others.

INEXPENSIVE OPTIONS

MEANWHILE, CONSUMERS seeking new ways of enjoying TV don't necessarily need an expensive flat panel. Visit any big TV retailer, and you'll find high-quality projector systems from HP, InFocus, Mitsubishi, and others priced under \$1,500. These aren't televisions exactly, but they can display the same programming in good resolution on 100-inch screens without taking up much space. You place the projector on a stand or hang it from the ceiling, hitch up a DVD player, or string cables from your TiVo or cable box, then project the image on large, roll-down movie screens—just like the old days of 8mm home movies.

That poses a potential threat to Asians companies pumping billions into flat panels. And so do recent changes in TV viewing patterns. With video streaming into cell phones, handheld game machines, and all manner of Internet devices, the time any family has free to stare at a single, monolithic screen—flat or fat—is limited. So the mass market that Asian television makers are targeting may not be rock-solid.

Can Sony, Sharp, Samsung, and the rest withstand the price pressures, shifts in viewing habits, and challenges from the likes of Dell? Some of the Asian champions will surely lose their shirts in cyclical downturns, and American interlopers will skim off part of the profits. But over time, Asia's flat-panel survivors will wind up with revenues, manufacturing expertise, jobs, technical insights, and an edge in innovation. The rewards may well justify the risks. ■

—With Moon Ihlwan in Seoul,

William C. Symonds in Boston, Andrew Park in Dallas, Stephen H. Wildstrom in Las Vegas, and Hiroko Tashiro in Osaka

BusinessWeek online For more on the flat-panel TV industry, including a slide show, go to www.businessweek.com/extras



THE ECONOMY

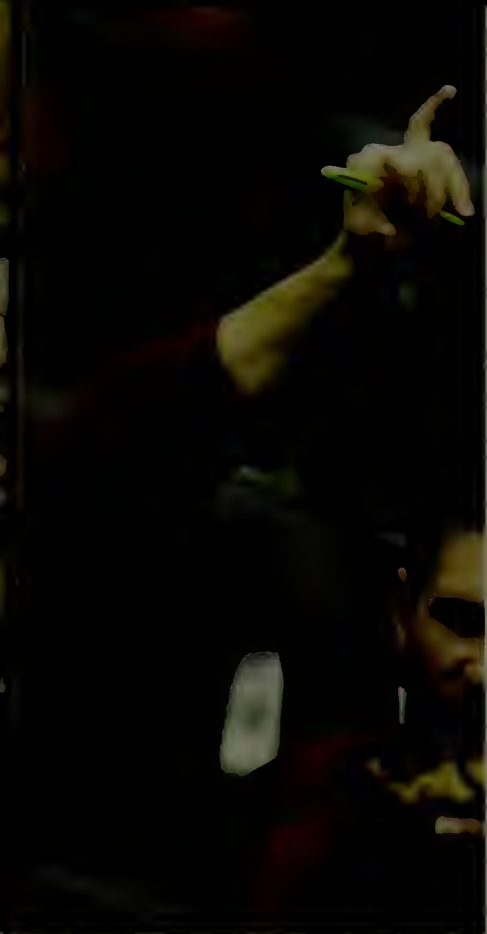
THE FED MAY BE TALKING TOO FREELY

Broadcasting its policy has sown market confusion and fanned inflation fears

FACED WITH THE THREAT of a deflationary downturn in the summer of 2003, Federal Reserve Chairman Alan Greenspan and his central bank colleagues embarked on an unorthodox monetary strategy. For the first time ever, they provided investors with specific guidance on future monetary policy, saying interest rates would stay low for a "considerable period." As the economy recovered and the Fed raised rates in response, it continued to try to manage expectations so as to avoid upsetting the markets, saying it would tighten credit at a "measured" pace.

But what started out as a well-meaning attempt to give investors a clear

sense of where monetary policy headed has degenerated into a muddled message that has sown confusion in financial markets and helped fan fear of higher inflation among investors. It has raised questions inside and outside the Fed about whether the central bank's extraordinary strategy of mollycoddling the markets has done more harm than good. "In retrospect, there have been more negatives than positives," says former Fed official Lyle Gramley, now with the Stanford Washington Research Group financial advisory firm. "The biggest fear: that the Fed's strategy of managing long-term interest rates backfired, overheating the economy and setting the stage for a revival of inflation."



raise interest rates more aggressively.

Indeed, such concerns sent stock prices skidding lower and bond yields soaring to their highest level in nine months on Mar. 22 after the Fed raised rates another quarter percentage point, to 2.75%. Uneasy investors ignored the Fed's declaration that it would continue to raise rates in tiny increments. Instead, they focused on the central bank's acknowledgment that inflationary pressures have picked up and marked up their expectations for coming hikes in the eurodollar and other interest-rate futures markets.

THE CARRY TRADE

WHEN THE FED first started to provide the markets with specific guidance on its policy intentions, it had a simple aim: It wanted to steer the economy clear of the deflationary abyss by better aligning long-term interest rates with the short-term ones it controls. After all, it is long rates—on everything from mortgages to corporate bonds—that are far more important to the economy.

Besides, with short-term interest rates at a 45-year low of 1%, the Fed was running out of room to ease credit more on that score. So it tried to exert its influence over long-term rates, not by buying bonds in the market but by committing to an easy monetary policy for an extended period, says economist Louis Crandall of consultants Wrightson ICAP. And the strategy worked. Even as the economy recovered, long rates remained low, anchored by the Fed's pledge of cheap credit.

But the tactic began to run into problems as the economy gained steam and the Fed began raising short-term rates last summer. Rather than rising in tandem with the Fed's actions, long-term rates fell. Indeed, it wasn't until their rise on Mar. 22 that bond yields were back to about where they were when the Fed embarked on its campaign of rate hikes in June, 2004. "The bond market has not done the Fed's work for it," says former Fed Vice-Chairman and current Princeton University professor Alan S. Blinder. The persistently low level of long-term rates has helped propel the economy forward, fanning fears of faster inflation ahead.

So why did bond yields stay so low? In part, it's because of the Fed's own policies. Reassured by the central bank's promise of "measured" rate hikes, speculators piled into what is called the carry trade: They borrowed money at low short-term rates, then turned around and invested that in higher-yielding bonds. That bond buying helped hold down long-term rates. Normally, such a strategy would be considered risky at a time of rising short-term rates. But hedge funds and other speculators felt

GREENSPAN
Is his guidance
misfiring?

they could get away with it because of the Fed's clear-cut policy of gradual rate hikes.

The controversy over how clear the Fed should be about its intentions harkens back to the mid-1970s, when monetarist Milton Friedman argued that a predictable policy path was the best way to control inflation and avoid meddling in the economy by well-meaning, yet inept, central bankers seeking to control output.

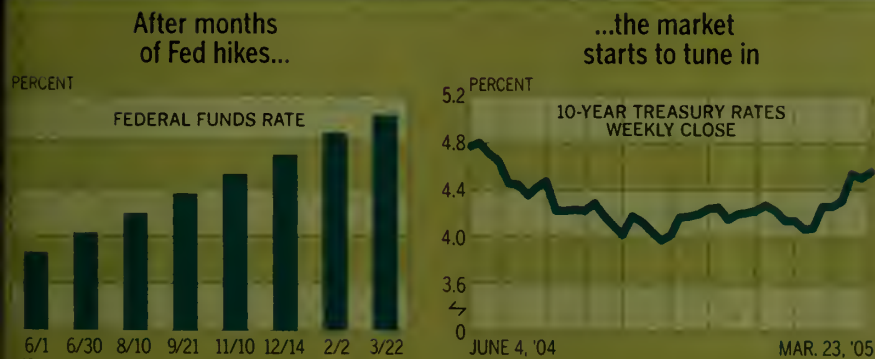
Fed officials always recognized that special circumstances enabled them to embark on their hands-on market strategy 1½ years ago. Inflation was low—uncomfortably so, in the minds of many at the Fed. Productivity was exceptionally strong. And although the economy was recovering, the upswing looked fragile.

The question now is whether the Fed stuck with that strategy for too long as the economic forces shifted to higher inflation, sturdier growth, and slower productivity. If it did, then the markets and the economy could be in for some bumpy times ahead as Greenspan & Co. try to cap the inflationary pressures they have unleashed. ■

—By Rich Miller in Washington



GETTING THE MESSAGE?



Data: Federal Reserve Board, Bloomberg Financial Markets

COMMENTARY

BY MICHAEL J. MANDEL

A Few Bad Apples Spoil... Not Much

Why imperial CEOs in the U.S. do less damage than entrenched elites elsewhere

WHEN IT COMES to U.S. corporate scandals, the bad news never stops. In the past few weeks alone, former WorldCom Chief Executive Bernard J. "Bernie" Ebbers was convicted of fraud, the Securities & Exchange Commission filed a civil suit against ex-head of Qwest Communications International Joseph P.

Nacchio, American International Group CEO Maurice R. "Hank" Greenberg was forced to resign, and Time Warner agreed to pay a \$300 million fine for accounting violations. Meanwhile, powerful CEOs continue to get huge pay packages.

Yet despite their magnitude, these sins are of the venial rather than the mortal variety. A venial sin, in economic terms, is an expression of greed that's reprehensible enough to warrant punishment but not so serious that it significantly undercuts the country's long-term growth. A mortal sin, by comparison, has the potential to impede innovation, condemning a nation to years of stagnation.

The fact is, CEOs in the U.S. lack the power to drag down entire industries or the economy as a whole. An executive like Michael Eisner of Walt Disney Co. may be able to exert total control over his or her company for decades. Yet the impact is limited to a single corporation. Company heads cannot hold back competition, and they cannot keep small companies from having access to capital. The imperial CEO, then, is much less pernicious than an entrenched government bureaucracy, an economy dominated by a few large families, or a single-party political system.

Such roadblocks to growth are far more common in Europe and Japan than they are in America. In Germany and France, for example, government protection of retailers has held down productivity gains in that sector. And in Japan, the ruling Liberal Democratic Party has dragged its feet on reform, making it harder to shed bad loans and shift resources

to new growth areas. That has held back Japan's recovery.

Despite all the scandals and the pay funneled to top executives in the U.S., corporations have done quite well for both investors and workers—unless, of course, you happen to have been employed at WorldCom or Enron Corp. Over the decade, the stock market has risen an average of 10% per year, outpacing the markets in other major developed countries. Wages have risen by a total of 8.6% over the same period, compared with only 0.6% over the previous 10 years.

Moreover, the gains have been surprisingly well distributed. When productivity began accelerating in 1995, employment for hourly workers, salaried managers, and professionals—reaping 65% of the nation's total income. Today they earn the same percentage, a sign they have received their fair share of gains. Corporate profits have remained steady at just under 10% of national income, suggesting that investors, too, on average

have gained from faster growth even if some lost their shirts.

**A guy like
Eisner only
controls one
company—
not a whole
industry**

Just as important, the U.S. regulatory system has been more than capable of dealing with corporate excess and fraud. The passage of Sarbanes-Oxley put some teeth in the reform process, while federal prosecutors have gone after high-profile corporate miscreants—albeit slowly. Even in the U.S., it's only the rare company that gets a government bailout. When Enron faltered in 2001, political connections enabled its chairman, Kenneth L. Lay, to get Federal Reserve Chairman Alan Greenspan to pick up the phone. But that did nothing to stop Enron from going under.

This ability to fix problems when things go wrong is one of the great virtues of the U.S. economic system. From the New Deal to the savings and loan bailout of the 1980s to the recent scandals. That's tougher than other countries to match, especially those with entrenched elites controlling entire industries. The U.S. term of "sin and repent" means it's sure bet there will be shameful periods of scandal. But it also means the U.S. economy has the ability to reinvent itself. It may not always be smooth, but it seems to work. ■



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MEDIA

FROM EXILES TO EMPIRE BUILDERS?

Big media's bust-up has former top execs forging new companies from the pieces

METRO-GOLDWYN-Mayer Inc.'s \$5 billion sale to a Sony Corp.-led consortium won't close for a few more weeks, but Alex Yemenidjian, the MGM chairman who crafted the deal, is already thinking about his next gig. According to filings by the studio, the 49-year-old dealmaker will collect more than \$140 million when the Sony transaction closes, enough to start his own company. Even so, Yemenidjian has been flooded with offers from potential investors—including MGM majority owner Kirk Kerkorian—to bankroll his next venture, be it in the media world or perhaps a casino. "A lot of people want to invest in me," he boasts.

ON THE OUTSIDE

THESE DAYS, MOGULS in exile—self-imposed or otherwise—are the hottest act in show business. After years of masterminding relentless consolidation, a small but growing corps of onetime movers and shakers is now watching from the sidelines as media behemoths split up. Indeed, in the wake of Viacom Inc.'s Mar. 16 breakup announcement, the new media buzzword is deconsolidation. And who better to preside over new media combinations built out of shards of the old? "A lot of the same guys who put the pieces together for these large companies are now on the outside with the knowledge of how they work and the means to get them back," says former Universal Studios CEO Frank J. Biondi Jr., whose Waterview Advisors has snapped up stakes in recent years in cable and other assets. Industry heavyweights such as former Viacom Entertainment Group CEO Jonathan L. Dolgen, former AOL Time Warner Chief Operating Officer Robert W. Pittman, and ex-Telecommunications Inc.

President Leo J. Hindery Jr. are all lining up money for deals.

At the same time, a slew of private equity funds and other investors are queuing up to help share the risks, enticed by the

industry's traditionally strong cash. Today, deep-pocketed investors such as Providence Equity Partners, Bain Capital, and Texas Pacific are just waiting to unload cash on media properties they will get a lift in the hands of proven dealmakers. Jerald L. Kent, former CEO of Paul & David's majority-controlled cable operator Communications Inc., has raised \$600 million from private equity such as Charterhouse Group and Oaktree Capital Management to help his own fund buy small systems and cell-phone towers. years back, there were maybe one or two funds that had \$1 billion to spend, Kent. "Now there are 50 or 60 of them, and some have \$5 billion."

A prototype for this new media game plan was the deal devised by Edgar M. Bronfman, the oft-derided liquor scion who lost part of his family fortune on Seagram's risky plays in Hollywood and the music in-

Moguls on the Loose

Sideline honchos are on the prowl for deals:

LEO HINDERY

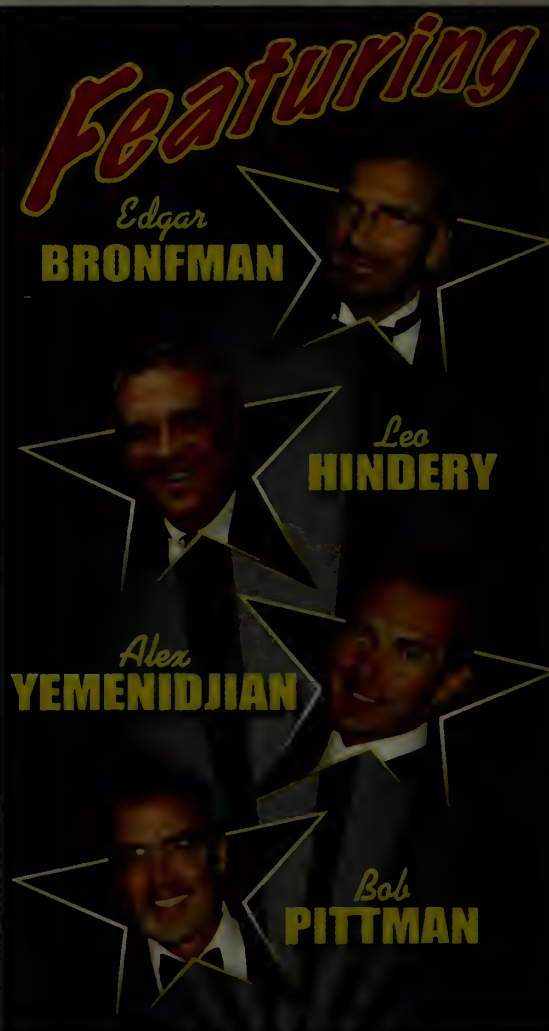
LAST ACT CEO, YES Network, and a former top exec at John Malone's TCI cable empire.

NEW ACT Launched InterMedia Advisors and is raising money to buy cable channels.

ALEX YEMENIDJIAN

LAST ACT Chairman and CEO of MGM. He engineered the sale of the studio to Sony, Comcast, and private equity firms.

NEW ACT Looking to buy casino or media assets.



EDGAR BRONFMAN

LAST ACT CEO of where the ill-fated merger Vivendi.

NEW ACT CEO of Music where he partner private

BOB PITTMAN

LAST ACT COO of Warner name la MTV.

NEW ACT Founder Group. looking stations Paramo theme p

late 2003, Bronfman lined up investors Providence Equity, Thomas H. Partners, and Bain Capital to back a \$1.6 billion purchase of Warner Music Group. Bronfman slashed overhead by firing off 1,600 workers and cut nearly a third of Warner's acts to help generate earnings of \$36 million in the first quarter, vs. a \$1.1 billion loss the previous year. More important for Bronfman and the other investors, they paid themselves \$350 million in cash from transactions in October, and in December \$700 million in new debt to essentially recoup nearly all of the \$1 billion paid out up less than a year before. And I have the potential to pull down a multiple if the initial public offering, announced on Mar. 11, is greeted warmly on the street. Bronfman was not available for comment.

SH IN CASH

IBLE NEW TARGETS include Universal Music Group, the music unit of New York-based Vivendi Universal, which last year sold its Universal studio, cable channels, and theme parks to General Electric Co.'s NBC unit. And as part of its effort to trim down, Viacom has said it will sell some radio stations, its five theme parks, the Famous Players distributor chain in Canada, and possibly publisher Simon & Schuster.

With so much money in the market, prices are bound to get more expensive. Dozens of bidders are interested in Paramount's theme parks, including former Time Warner and Six Flags Theme Parks executive Pittman and Thomas McGrath, an erstwhile Paramount COO. Prices are already rising in some sectors. Theme parks and theater chains trading at high as seven times cash flow a year ago are now getting nine to 10 times, says McGrath. Undeterred, McGrath is allied with Goldman Sachs & Co. and Spectrum Equity Partners to bid nearly \$1 billion for the theme parks. But are execs from the old media empires nimble enough for today's ever-changing world? "The big challenge for executives used to protecting the crown jewels is whether they can take on a disposition as investors," says Dennis A. Ber, a partner with Bear Stearns Asset Management Inc.'s Constellation Ventures, which invests in media startups. "You don't think entrepreneurially, you won't succeed." And what will be the measure of that success? To sell back to a larger media player, of course. ■

—By Ronald Grover in Los Angeles and Tom Lowry in New York

THE INTERNET

WHY SECOND-TIER SITES MAY BE WORTH TOP DOLLAR

With Web ad rates on the rise, more acquisitions of the likes of Ask Jeeves may be in store

WITH ONLINE ADVERTISING the biggest thing since the 30-second TV spot, it's easy to see why Web sites with strong ad revenues are tempting takeover targets. The latest deal happened on Mar. 21, when IAC/InterActiveCorp announced it will buy search site Ask Jeeves Inc. The Jeeves deal followed New York Times Co.'s acquisition of Primedia Inc.'s About.com, which closed on Mar. 18, as well as Dow Jones & Co.'s purchase earlier this year of investing site MarketWatch Inc.

IAC's offer of \$1.9 billion in stock for a search business that ranks a distant fifth worldwide raises the question: Are these second-tier companies worth all this loot? The answer is a qualified yes. While About.com commanded 23 times this year's expected cash flow, and Jeeves went for about 20 times this year's expected profits, analysts point to strong growth in the online ad market as justification for the lofty tabs. Indeed, the Interactive Advertising Bureau expects Web ad revenue to rise 20%, to \$11.5 billion, this year.

As a result analysts predict more acquisitions. "People are looking for exposure to search advertising," says Mark Mahaney, an analyst at American Technology Research Inc. in San Francisco. "There are only so many names out there."

Among them: Shopping.com, ValueClick, InfoSpace, and FindWhat.com. As the leading price-comparison site, Shopping.com is considered a prime target, thanks to expected annual earnings growth of 27% for the next five years. InfoSpace is positioned to ride two trends: Web advertising and wireless services,

especially games delivered to cell phones. ValueClick, an online advertising agency, represents a broad play in Web advertising. FindWhat.com, a relative minnow in search, could be gobbled up by a Google or Yahoo! Inc. as consolidation gathers momentum.

DISCOUNT SHOPPING

RAPIDLY RISING ONLINE advertising rates, especially for search, are driving up the strongest players' revenues and profits—a key reason to buy one. Jeff Lanctot, a vice-president at Seattle-based Avenue A/Razorfish, the largest buyer of search ads in the U.S., says rates rose an average of 25% to 30% last year.

What's more, with lots of money pouring into energy and other cyclical stocks, ad-driven Web companies have become relative bargains. Shopping.com, at about \$18 a share, is off nearly 50% since October. InfoSpace Inc. is down nearly \$20, to \$39, since last fall. And ValueClick Inc. and FindWhat.com Inc., respectively \$11 and \$10, are trading at price-to-earnings multiples level with or below expected profit growth—typically a sign of cheap stocks.

What will it take to spark the next round of dealmaking? Buyers will want to pay today's stock prices, as IAC

Chief Executive Barry Diller did to lock down Ask Jeeves, which, at \$28 a share, is off \$16 since last year. But sellers may want to avoid the criticism Ask Jeeves CEO Steve Berkowitz took for selling at what some investors see as a cheap price. The bottom line: Speculators could get burned betting on mergers, but investors counting on long-term earnings growth could get some nice buyout surprises along the way. ■

—By Timothy J. Mullaney in New York



STRATEGIES

LARRY, YOU PICKED A NASTY FIGHT

In taking on heavyweight SAP, Oracle faces very long odds

WHEN ORACLE CORP. announced it had acquired retail-industry software maker Retek Inc. for \$650 million on Mar. 22, it brought to an end a tumultuous, three-week bidding battle with corporate software rival SAP. The operatic contest included a series of frenzied bids and counterbids and even corny gibes by Oracle Chief Executive Lawrence J. Ellison, who continually referred to SAP as "sap." Ellison snatched Retek away from SAP—which had bid first. But when the dust cleared, the prize looked paltry. To get a foothold in the retail industry, Oracle paid nearly a 100% premium for a little-known Minneapolis company with 525 employees and revenues of just \$174 million last year. What's it all about?

This is a small piece of a very big battle: Oracle vs. SAP for dominance of the \$47 billion market for corporate applications software. And neither side is giving an inch. The once-fast-growing market for applications software—which is used to manage accounting, purchasing, human resources, and customer relations—grew just 5% last year. Both companies need to grab share to boost their revenues. SAP is the long-time leader, so in an effort to gain ground, Ellison has embarked on a risky strategy. The first step was his \$10.3 billion hostile takeover of No. 2 applications player PeopleSoft Inc., which was concluded Jan. 7. Now, Ellison is making

a series of smaller acquisitions, and ultimately he plans to meld four product lines into a single package called Project Fusion. "SAP is a formidable company, but we have a shot at catching them," says Ellison.

Ellison's plan marks a detour for Oracle. The company's main business is selling database software, and it clearly dominates that market. On Mar. 22 it reported that revenues in the most recent quarter jumped 18%, to \$2.95 billion, mostly fueled by database sales. Earnings dropped 15%, to \$540 million,

“Oracle will pressure us only if they make better applications, and I haven't seen that so far.”

—CEO Henning Kagermann of SAP



“SAP is a formidable company, but we have a shot at catching them.”

—CEO Lawrence J. Ellison of Oracle



because of costs related to the PeopleSoft acquisition. But with PeopleSoft and other acquisitions, Ellison is picking up a huge base of customers to which he can sell databases and additional applications. He's betting that Oracle's integrated package of databases, applications, and software that links it all together will be snapped

up by corporations eager to simplify their computing systems.

By picking a fight with SAP, though, Ellison is taking on a heavyweight heavily favored to punch his lights out of the applications market. With 26 corporate customers worldwide and a broad suite of products, SAP has become the gold standard for corporate applications. Goldman, Sachs & Co. expects, among the top four players, SAP's software license revenues will vault 59% in 2003 to 70% this year. Meanwhile, the firm expects Oracle's share (with PeopleSoft included) to fall from 30% to 20%. "There will be a lot of marketing rhetoric, but at the end of the day, SAP has the momentum that Oracle won't be able to dislodge them," says Goldman analyst Richard G. Sherlund.

ORACLE'S FULL PLATE

SAP HAS DEFINITELY gone on the offensive. Before the ink had dried on the PeopleSoft merger, SAP began tempting PeopleSoft customers with a 75% discount on switching over. Last year, the 33-year German company lured several former Oracle customers, including PepsiCo. CEO Henning Kagermann dismisses Oracle's acquisitions as a second-rate strategy. "Oracle will pressure us only if they make better applications, and I haven't seen that so far," Kagermann says.

How the two rivals will form in the coming year will probably decide the outcome. Oracle will have its hands full integrating PeopleSoft, Retek, and other additional acquisitions. Project Fusion is not expected to be finished until 2005. Meanwhile, SAP is remodeling its applications and software program called NetWeaver, which will allow customers to build customized programs using SAP's products. SAP is hiring 1,000 engineers in an effort to finish the project in 2007—a year ahead of Oracle's Fusion.

This race is on. The technical challenges are huge, and either side could stumble. But the most intense pressure is on Ellison. He has set his sights on SAP before, and not much came of it. Now he's trying again, and the stakes are higher than ever. ■

—By Steve Hamm in New York with
Andy Reinhardt in Palo Alto

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CONSUMER ELECTRONICS

MAJOR HANGUPS OVER THE IPOD PHONE

Cellular carriers are hesitant to sell the Apple-Motorola gizmo. Here's why

IT SEEMED LIKE A SURE THING: the iPod mobile phone. What could be more irresistible than a device combining the digital-music prowess of Apple Computer Inc. with the wireless expertise of Motorola Inc.? Motorola sent its buzz machinery into overdrive in January when it leaked word that the product would debut at a cellular-industry conference in New Orleans in mid-March.

Well, hold the phone. At the New Orleans confab, a frustrated Edward J. Zander, Motorola's chief executive, stood before a roomful of analysts and reporters and said the handset's debut would have to wait. Why? Zander said Motorola and Apple want to hold off until the phone is closer to hitting store shelves. But three industry sources say a lack of support from such giant cellular operators as Verizon Wireless and Cingular Wireless was instrumental in delaying the unveiling. So far the wireless companies are reluctant to promote the Motorola-Apple phone.

Behind the clash are two very different views of the future of music on mobile phones. Motorola and Apple would let customers put any digital tune they already own on their phones for free. That would help Motorola sell more phones, and it would help Apple expand its dominance of digital music. Verizon, Cingular, and other wireless operators want customers to pay to put music on phones. They think getting a full song should be like getting a ring tone, snippets for which customers now pay from 99¢ to \$3. The carriers have no interest in conceding the booming digital-music market to the

tech players. "When carriers see this future, Apple is front and center," says Andrew Cole, head of the wireless practice at consultant A.T. Kearney Inc. Apple is "a competitor not to be embraced, but to be rejected."

At issue is whether Apple and Motorola leave room for carriers to benefit. Their phone could be loaded with songs simply by dropping it into a cradle attached to a PC, so that music wouldn't have to travel over carriers' airwaves. There's not a whole lot of profit to share, either. When customers buy songs from Apple's iTunes music store, they pay 99¢ a tune. But Apple only gets about 4¢ of that, after paying the record company and others, says researcher Strategy Analytics. Apple says iTunes is only a breakeven business.

That approach doesn't sit well with the megacarriers—and they can hamper the sale of any cell phone. Verizon and others

typically subsidize the phones they sell to customers, often charging \$200 less for handsets at retail than what they pay Motorola and others. Says Jeffrey D. Hallock, Sprint's vice-president for strategic marketing: "We need to figure out a way

that is economically viable for Sprint."

One way would be for U.S. carriers to follow the model that has been established in Europe. There, carriers such as Vodafone, Orange, and O2 have set up their own digital music stores, letting customers download music tracks over their cellular network to their phones. Carriers get a slice of the \$2.80 customers pay per song. Wireless players also could offer customers subscription services, with access to thousands of songs for a monthly fee of \$15 or \$20.

U.S. carriers hope to position themselves as major players in digital music and to steal the spotlight from Apple. Their ideal

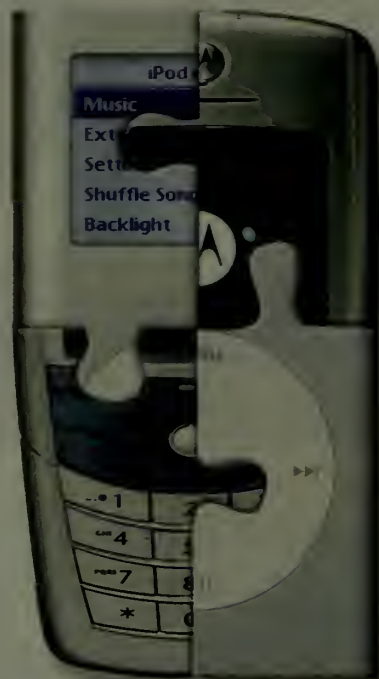
scenario would be for carriers to use their mobile phones as digital jukeboxes, plugging headphones to listen the go and dropping the phone into a cradle attached to stereo speakers at home. While Apple and Motorola may object, wireless operators can buy music-downloading handsets from phonemakers that are willing to play by their rules—perhaps aggressive Asian players such as Samsung and LG. "There is a sweet spot between mobility and music," says James P. Ryan, Cingular's vice-president of consumer data services.

Apple and Motorola have options, too.

Insider says that even if Cingular and Verizon, the two largest wireless players, won't sell the Motorola-Apple phone, smaller rivals, such as T-Mobile, may jockey to gain ground on the industry leaders. Motorola says it's working out a deal for carriers to profit from digital music and expects to launch the phone with support this summer. Motorola and Apple could also bypass carriers altogether and sell the phone via retail stores or their own Web sites.

Trouble is, that would mean no carrier subsidy on the handsets. So customers would have to foot the music phone's full price bill, expected to be around \$500. "Who wants the \$500 iPod phone when you could buy a phone and an iPod for that much?" says analyst Tole J. Harter of research firm Gartner Inc. A sure thing? The iPod phone now looks anything but.

—By Roger O. Crockett in Chicago, and Peter Burrows in San Francisco



ALL IN ONE
But little profit for carriers

HIGH STAKES



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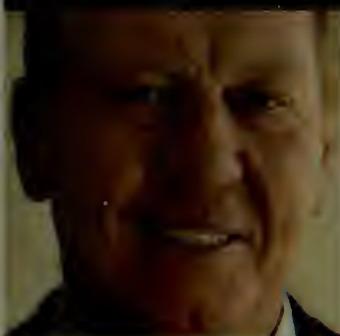
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HEADLINER

NEVILLE ISDELL



SHAKING UP COKE ABROAD

Not long after Neville Isdell came out of retirement last May to become CEO of Coca-Cola, he set off on a whirlwind world tour of Coke's far-flung operations. On Mar. 23, the outcome of Isdell's trip became evident with a restructuring that does everything from beefing up Coke's marketing to splitting the key European and Asian regions into smaller groups.

As part of the shuffle, Asia chief Mary Minnick gets a job overseeing both marketing and new product development in Asia. Isdell recruited French bottling exec Dominique Reiniche to oversee European operations. And he brought back Coke alum Muhtar Kent to oversee one of the restructured Asia divisions.

Now that Isdell is surrounded by a band of loyalists, perhaps he can avoid the internecine warfare that undermined his two predecessors, Doug Ivester and Doug Daft. "He's building a team that's going to be loyal to the leader," says a former executive. "Given the recent history at Coke, that's a good thing."

—Dean Foust

HOW GM MAY SHRINK ITSELF

General Motors may not be planning any big restructuring moves yet, but it's watching weaker divisions like Pontiac and Buick, company Vice-Chairman Robert Lutz said at a Mar. 23 conference sponsored by Morgan Stanley. "Over time, if one troubled brand fails to turn around, we would have to take a closer look at phasing it out," Lutz said. He added: "We're hoping not to do that." Still, GM is looking to cut costs, and fast. And it's becoming clear that it wants help from the United Auto Workers. One idea: asking hourly workers to pay more of this



year's estimated \$5.6 billion health-care bill. "There is a range of things we can do to work on health-care costs," GM-North America President Gary Cowger said in an interview on Mar. 23.

REVIVING PARAMOUNT

Viacom's beleaguered Paramount Pictures unit is in final talks to nab Fox network chief Gail Berman, in a coup for Viacom Co-President Tom Freston, who wants to overhaul the studio. Berman, the network executive behind such Fox hits *American Idol* and *24*, is likely to be named Paramount president. She'll

report to onetime talent manager and TV producer Brad Grey, named studio chief in January. With the two TV executives at the helm of Paramount, Viacom hopes to bring more youth-oriented entertainment to the studio, which has recently released such bombs as *The Stepford Wives* and *Alfie*.

A BULGING FUND DRAGNET

The Securities & Exchange Commission's crackdown on misleading mutual-fund sales isn't over yet. On Mar. 23, Putnam Investment Management and Citigroup Global Markets agreed to settle separate charges that they failed to disclose payments linked to promoting funds. Putnam, a unit of Marsh & McLennan Cos., agreed to pay \$40 million without admitting or denying wrongdoing. Citigroup, which also did not admit or deny the charges, agreed to pay \$20 million. The SEC contended that Putnam struck marketing deals with brokerage firms to promote its funds and in exchange steered trades to them but failed to adequately disclose the arrangements. The SEC alleged that Citigroup failed to fully disclose extra payments it got for giving preferred treatment to 75 mutual-fund groups.

BAD DAY FOR GENERICS

Sanofi-Aventis and Bristol-Myers Squibb won a skirmish in their efforts to fight off generic challenges to their jointly marketed stroke treatment Plavix, the third-best-selling drug in the world. A Canadian court ruled on Mar. 22 that a knockoff of the drug by

Toronto's Apotex would violate Plavix' patent, due to expire in 2012. A similar case filed by Apotex and Dr. Reddy's Laboratories of India is pending in New York, and analysts speculate that the Canadian victory could bode well for Sanofi's case in the U.S.

ET CETERA...

» A Dubai private equity firm bought waxwork museums owner Tussaud Group for \$1.51 billion.

» Social Security trustees say the fund will start shrinking in 2017, earlier than expected.

» Higher oil prices could add up to \$1 billion to Delta Air Lines' costs, its CEO says.

CLOSING BELL

XM Satellite Radio shares jumped 8.6% on Mar. 23, to \$30.45, on the news that Hyundai Motor America will be the first auto maker to install XM radios as standard equipment in its 2006 models. Rival Sirius Satellite Radio also rose, by 2.7%, to \$5.42, on its own deals.



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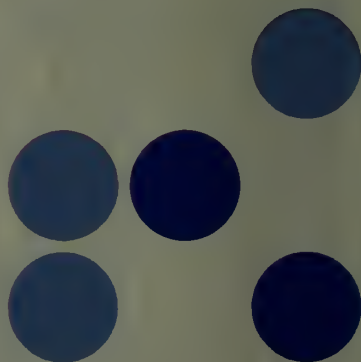
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EDITED BY RICHARD S. DUNHAM

Congress Draws a Bead on Predatory Lending

THE TURF FIGHT IS BREWING between the states and Washington over who should set the rules to protect consumers from ravenous financial interests. This time, it's mortgage lenders in the middle. Since 1990, high-priced loans for home buyers with lousy credit have exploded, leading states to put "subprime"

lending under a microscope. So the mortgage bankers are lobbying hard in the national capital to blunt the crackdown. The bankers are hailing a House bill that would preempt state regulations and set national standards for predatory lending. The catch: The federal rules would be weaker than laws now on the books in many states. A bill to curb "predatory lending"—high-priced loans loaded with fat prepayment penalties, and other abusive practices—has been kicking around for years. But now Democrats are jump-starting, giving the measure new momentum. "If ever the stars were aligned, it's now," says James Ballantine, director of community development at the American Bankers Assn.

Latest Round

PENDING TO escalating complaints of predatory lending, 31 states have enacted laws since 1999 restricting subprime loans. State attorneys general have stepped in to police abuses. This year, AGs of 25 states launched an investigation of the first mortgage, the first of the nation's biggest subprime lenders. The Orange (Calif.) mortgage company declines comment on the substance of the probe but says it is "working to resolve the issues under discussion." The showdown is the latest round in the state-vs.-feds battle over financial policy, a battle that includes dustups over privacy and lobbyists' conflicts of interest. Mortgage lenders gripe that conflicting state laws make it tough for them to operate coast to coast. And state-chartered lenders say they're at a disadvantage to national banks, which were exempted from state laws un-

der a rule adopted in 2004 by the Office of the Comptroller of the Currency.

Alarmed by that rule, Democrats are starting to back the GOP's push for a national standard. On Mar. 15, Representative Paul E. Kanjorski (D-Pa.), the No. 2 Democrat on the House Financial Services Committee, broke ranks to team up with Representative Bob Ney (R-Ohio) on a bill to preempt the states. Eight other House Democrats are co-sponsors. The price of their support: provisions to reform mortgage services and appraisals, plus minimum standards for licensing mortgage brokers.

But state officials are opposed. "I'd like to see a good federal standard—as long as it doesn't preempt the states," says North Carolina Attorney General Roy Cooper, a Democrat. AGs contend that states can respond more quickly to abuses. And many don't trust GOP-led Washington to pass a stringent rule. Consumer advocates back a bill championed by Representative Barney Frank (D-Mass.) that would not preempt the states.



FRANK His bill is tougher than the one proposed by Republicans

The lenders and their Hill allies face a hard slog. GOP leaders will be preoccupied for months with schemes to overhaul regulation of Fannie Mae and Freddie Mac. But the heat on predatory lending could rise in August, when the Federal Reserve is to report on loan terms and demographic trends in subprime lending. The report is widely expected to show that minorities tend to be saddled with higher-priced loans. Lenders figure this will light a fire under Congress. But if the stats are bad enough, it's the lenders who could get burned. ■

—By Amy Borrus

CAPITAL WRAPUP

HEALTH CARE: A RIGHT FOR SCHIAVO—OR ALL?

DO GEORGE W. BUSH and the GOP Congress believe there is a constitutional right to health care? It seems they may—for Terri Schiavo. But liberals may try to extend that right to everyone.

Their reasoning: In the law approved on Mar. 20 giving federal courts jurisdiction over the Schiavo case, Congress opened a door for those courts to grant her a constitutional right to "food, fluids, or medical treatment necessary to sustain her life." The law was written to apply only to Schiavo, so it asserts that she alone has a right to unlimited health care.

Most scholars think the new law is unconstitutional. But if the courts side with Congress, health-care advocates would love to extend that right to millions of low-income families. "If this statute gets upheld," says Vicki Gottlich, a lawyer for the Center for Medicare Advocacy, "there will be lots of attorneys looking for ways to use it. I'd be saying my client is in the same situation."

Obviously, such a right would cost plenty. And Congress now limits such spending. The same week the Schiavo law passed, the House voted to include \$20 billion in Medicaid cuts in the upcoming budget. Medicaid pays for two-thirds of total long-term care costs for patients such as Schiavo. In her home state of Florida, Governor **Jeb Bush** wants to cap the amount of Medicaid funds that could be spent on any patient.

—By Howard Gleckman

Congress may cut funds for long-term medical care

Greater Nagoya Is Ready To Take Off

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**GREATER
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"Once you establish a business connection in Nagoya, it usually makes for a long, comfortable relationship," says Chihiro Yasuda, president of EdgeCAM K.K., one of the foreign affiliated firms that has benefited from the Greater Nagoya Initiative (GNI).

The GNI is a collective of representatives from business, academia and government focused on positioning Greater Nagoya as a manufacturing and commerce hub for Japan and infusing the area with new ideas, technologies and foreign investment.

Activities of the GNI coincide with two big events. In February, Centrair, Nagoya's new 768 billion yen international airport, opened with 24-hour service and direct flights to the USA and Europe. On March 25, the 2005 World Expo in Aichi will begin its six-month run. Organizers expect around 15 million visitors.

"Centrair will have a huge impact on the area because it will be a hub for connecting international flights with domestic destinations," says Hideki Ogawa, Director-General of the Chubu Bureau of Japan's Ministry of Economy, Trade and Industry.

Comprising a 100-km radius from Nagoya, Japan's third largest city, Greater Nagoya is an integrated economic region that includes Aichi, Gifu and Mie prefectures. Nagoya's port is Japan's largest export gateway, and the area, which is home to Toyota, produces 44% of all automobiles and 45% of all auto parts made in Japan. Those numbers are even more impressive given that Japan has six of the world's top 15 carmakers and produces 30% of the cars sold in the world.

"Greater Nagoya is the country's most concentrated manufacturing center. In addition to automotive, nearly 50% of the output of Japan's leading industrial sectors such as metalworking, machine tools, and liquid crystal displays are produced in the region," says Ogawa.

Perhaps that's why Nagoya was a natural fit for EdgeCAM, the Japanese subsidiary of Pathtrace PLC, a U.K. technology group specializing in computer aided engineering and production machining. EdgeCAM makes CAD software that's essential to the molding processes in automobile manufacturing.

EdgeCAM was able to get a running start in Nagoya, thanks to the Japan External Trade Organization (JETRO), a Japanese government-funded body promoting trade and investment in Japan. JETRO provided EdgeCAM with free space, administrative services and support staff for the first four months of business.

"When we started out, we were so busy that we were in the office most of the time," says Yasuda. "However, we didn't miss a beat, because JETRO provided us with lots of support, including strategic consulting, arranging meetings and acting as a receptionist."

While Greater Nagoya is known as a manufacturing hub, Hideki Ogawa sees Centrair as the impetus to a wide range of business opportunities for outside investment, including biotechnology, nanotechnology and service businesses, such as hotels and restaurants, to accompany the influx of travelers.

"This area is ideal for businesses looking to form technological alliances and partnerships," says Ogawa.

To help facilitate such alliances, there's the GNI Partners Club. A group of 250 Japanese companies with offices in Greater Nagoya who might be interested in working with foreign companies. Foreign firms interested in finding partners in the Nagoya area can obtain a list of GNI Partners Club members.

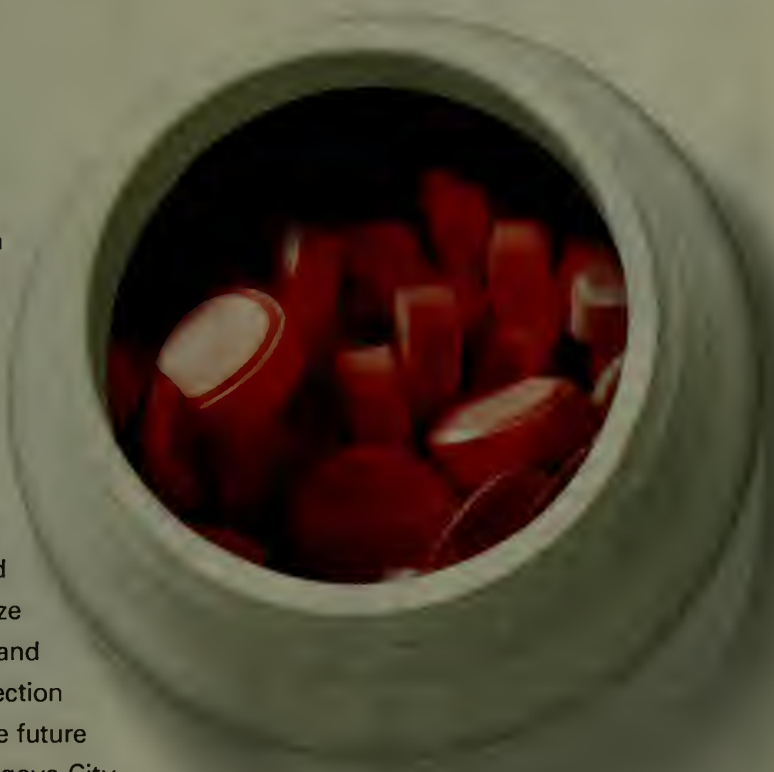
"Business success in Japan requires long term approach, but if you make it here, you can make it anywhere in the world, because the level of technology, the demand for quality and service are all top class here. And the philosophy best suits the Nagoya style of business," says Yasuda.

For further information, visit : www.greaternagoya.org

How Pfizer found a perfect cure in Greater Nagoya, Japan.

Developing and providing cures for an ailing world can be a risky business. To maximize the rewards, Pfizer, a world leader in pharmaceuticals, pursues profitable remedies as its Pfizer Research Laboratories in Greater Nagoya — home to manufacturing that embodies Japan's industrial spirit. This integrated economic region covers a radius of 100km from Nagoya — Japan's second largest metropolis after Tokyo and Osaka. Among Japan's most dynamic locations promoting advanced science and technology, this area boasts a Nobel Prize winner based at Nagoya University, deep professional and academic expertise, rigorous intellectual property protection and generous incentives. Greater Nagoya's focus on the future is also backed by about 300 foreign companies in Nagoya City alone. The new Nagoya Science Park, Central Japan International Airport and EXPO 2005 promise to keep raising the region's profile as a hub of 21st Century R&D and commerce. It adds up to a healthy prognosis for multinational corporations here in the long run.

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BEWARE OF HOT MONEY

With foreign cash piling in, China's economy could boil over

HOW FROTHY IS SHANGHAI's property market? Well, consider this: New hundred-square-meter apartments in posh sections of Shanghai have doubled in value, to \$550,000, since 2003. High-end properties in the Chinese megalopolis have shot up 20% during the past three months alone. It's not just Shanghai. UBS Securities says overall urban land and property prices in China last year were up 70% over 2001. Hong Kong and Taiwan-based investors have been snapping up flats in China for years, but new money is flooding in from Japan, Korea, and Europe, says Clement Luk, a director with Centaline (China) Property Consultants in Shanghai. "It really is crazy," he says.

The real estate buys are just one sign that China has more money than it knows what to do with. The country last year pulled in \$500 billion in export earnings, \$60 billion from foreign direct investment, and some \$129 billion in additional capital inflows—including massive bets on a rise in the value of the yuan, says Standard & Poor's. And the capital inflow shows signs of intensifying. Chinese exports in January and February alone were up a third over the first two months of last year. China's global current account surplus could hit \$100 billion or so in 2005, up almost two-thirds from last year. Foreign currency reserves could reach \$800 billion this year and, at this rate, could top \$1 trillion by 2006.

JOHN KUCZALA; CHART BY ALBERTO MENA/BW



The rush of funds threatens China's ability to absorb it. In the worst case, the country's money supply could run off the rails, creating a bubble that affects not only Shanghai real estate but also an array of key industries. Worse, it might set off an inflationary spiral with global implications.

TOUGH ACT TO FOLLOW

THE CHINESE GOVERNMENT vowed to clamp down on these excesses last year. Last March, Chinese President Hu Jintao and Premier Wen Jiabao started leaning on Chinese banks to curb lending to overcrowded industries such as steel and aluminum. At the same time, the government issued loads of bonds and notes to soak up extra liquidity. That kept money-supply growth at a manageable 14.6% through 2004, down from 20% in December, 2003. Even while capital spending cooled, the economy still grew nearly 10%. By the end of last year, Beijing seemed to be making headway in preventing the economy from boiling over.

Not so fast. Given the rate at which money is pouring into China, it's not at all clear that Beijing can repeat that balancing act in 2005. It looks like the People's Bank of China, the central bank, will have to recycle anywhere from \$300

million to \$500 million a day in 2005.

How do Chinese monetary authorities cope with this flood? To defend the fixed currency peg between the yuan and dollar, the central bank buys (or sells) foreign currency in exchange for yuan. When too much yuan is circulating around the money system, the PBOC withdraws that extra cash through what money traders call "sterilization"—issuing notes and bonds.

Here's how sterilization works: Chinese companies that earn export earnings in dollars and other foreign currencies usually have their banks exchange them for yuan. A company with \$100 million in export earnings could wind up with some 800 million yuan in its bank account. Foreign investors also ship dollars into China by the truckload to spend on new plants and securities. This money is converted into yuan deposits, too, giving China's banks huge wads of yuan to lend. In the past the banks had a bad habit of recklessly lending this money for construction of steel plants and other industrial enterprises. To keep a lid on such lending, the PBOC has been selling short-term bills to the banks, taking excess yuan out of circulation.

Right now the cost of neutralizing the flows is low. The PBOC can sell its short-term central bank bills to Chinese banks for 1.5% and reinvest that cash in longer-range domestic and foreign bonds at higher returns. Yet if the government bumps up interest rates to cool China's economy, this mopping-up process could get expensive, driving up the already sizable liabilities of the Chinese government. The other risk is that China's foreign exchange stockpile—already equal to about 40% of gross domestic product and parked mostly in U.S. Treasuries—could face a valuation hit if the yuan appreciates.

"The more accumulated [reserves], the greater the losses," says Frank F.X. Gong, chief China economist at JPMorgan Chase & Co. in Hong Kong.

Analysts give the central bank high marks for its efforts. But even the PBOC can't corral all the speculative money coming in. Overseas Chinese investors in

Hong Kong and Taiwan are converting billions of Hong Kong and Taiwan dollars into yuan to buy property, and so are other foreign investors—a logical move if you think the yuan will appreciate and real estate prices will hold. Another force is mainland Chinese companies that see an arbitrage opportunity, borrowing abroad and flipping the proceeds into yuan to invest in operations back home. Outstanding foreign-denominated debt (mostly dollars) borrowed in China grew 18%, to \$228 billion, in 2004 year-on-year. Paying back foreign loans in yuan is a sweet deal—if the yuan strengthens. "Every CFO at a

Chinese company is trying to find ways to borrow in dollars," says Nicholas Lardy, a senior fellow and China watcher of the Institute for International Economics.

One way to dampen flows of borrowed money is to raise interest rates, which the central bank has tried. On Mar. 17, China raised the interest rate for mortgage loans of five years by 20 basis points, to 5.51%, while increasing the required down payment to 30%, from 20%, on deals in cities experiencing rapid rises in prices. Credit Suisse First Boston economist Dong Tao sees more interest-rate hikes by late 2005. But the sure way to cool the ardor of the quick-money crowd would be a sudden, substantial revaluation. China watchers, including Lardy, think it would take a 15% to 25% hike against a basket of foreign currencies to slow money flows.

There are few signs that such drastic measures will be taken anytime soon. Chinese leaders are obsessed with job security in the country's vast farm sector, which could be hurt by a flood of foreign grain if imports get cheaper. Beijing also wants to keep export factories humming, but a more expensive yuan could weigh on demand. Most observers expect at most a token boost to the currency. Or the government may do nothing at all. If so, the Chinese—and the world—face another year of living dangerously. ■

—By Brian Bremner and Frederik Balfour in Hong Kong, with Dexter Roberts in Beijing

SURPLUS CITY

China's global current account surplus is rising fast on surging exports and capital inflow



The sure way to cool the ardor of the quick-money crowd: A revaluation

BusinessWeek online For excerpts from an interview with China watcher Nicholas Lardy, go to businessweek.com/extras



NOT SO CLEAR A350 financing is tied up

U.S. negotiators said the talks had broken down because the European Union had balked at ending the loans. The European countered that the U.S. was unwilling to discuss subsidies that benefit Boeing, including Japanese aid to local companies that are suppliers on Boeing's new 787 Dreamliner. The two sides now say they're willing to resume talks.

AVIATION

AIRBUS: WHO'S FLYING THIS PLANE?

Its headaches are only mounting as the search for a new CEO continues

AIRBUS HAS BEEN FLYING under the radar. With archrival Boeing Co. reeling from the ouster of Chief Executive Harry C. Stonecipher, it's easy to forget the European planemaker has a vacancy, too. The current chief, Noël Forgeard, was picked in December as co-CEO of Airbus' parent, European Aeronautic Defence & Space Co. But infighting between French and German interests within EADS has delayed the choice of a successor. The company now says it won't name a new Airbus CEO until Forgeard decamps to EADS in early May.

The new boss could be in for a bumpy ride—even as Airbus in 2005 looks set to celebrate its third consecutive year as the world's largest planemaker. A nasty U.S.-European dispute over aircraft subsidies is complicating the financing of its next new plane, the midsize A350. A weak dollar is squeezing the bottom line, because Airbus planes are priced in dollars but manufactured mainly in the euro zone. The search for Forgeard's successor could leave bruised feelings, too.

Until recently it was assumed that when Forgeard left, he'd pass the controls to Gérard Blanc, an Airbus veteran. But Blanc was vetoed by German interests within EADS, who resented him for push-

ing to assemble the superjumbo A380 in France rather than Germany. The lead candidate now, insiders say, is Fabrice Brégier, the head of EADS' helicopter business. Although well-regarded, Brégier has no experience in commercial jets. "There's a danger he could be a figurehead," says Doug McVitie, a Scottish aerospace analyst and ex-Airbus exec.

The latest trouble to hit Airbus involves a spat over subsidies. Washington and Brussels began talks in January after the U.S. threatened to pursue a complaint before the World Trade Organization over European government loans that have financed up to one-third of the development costs of Airbus planes. On Mar. 18,

Yet the longer the fight goes on, the greater the risk is to the A350, Airbus' answer to the fuel-efficient 787. Airbus wants to get the plane airborne by 2010, two years after the Dreamliner is scheduled to enter service. Airbus posted an impressive 42% gain in operating profits in 2004, to \$2.5 billion, on sales of \$26 billion. Yet it doesn't have much cash to spare for a big new project like the A350, whose start-up costs could exceed \$5.5 billion if customers push for features such as enhanced fuel efficiency. Parent EADS was left with only \$2.3 billion in free cash flow last year, 16% less than in 2003, after shelling out more than \$2 billion for the A380. Because of the dollar's weakness, outgoing EADS co-CEO Philippe Camu warns the megaplane might break even later than anticipated.

AVOIDING A TRADE WAR

COULDN'T THE European government just fork over the loans for the new A350 and take their chances on a fight at the WTO? EU and EADS officials have said they are prepared to do just that. But the new EU Trade Commissioner, Peter Mandelson, is eager to avoid that scenario. "He feels it's important that this issue not contaminate other EU-U.S. relations," says a source close to him. A trade war could also jeopardize EADS's efforts to sell air-refueling tankers to the U.S. Air Force.

Some Airbus watchers suspect that Forgeard will try to keep steering the company even after he moves over to EADS. But EADS is scrambling to bulk up its defense business, particularly in the U.S., to offset its dependence on commercial plane sales. Forgeard also may need to mend fences with DaimlerChrysler, EADS' chief German shareholder. The Germans swatted down a French proposal last year to end the Franco-German dual CEO arrangement. They also recently vetoed a suggestion that EADS merge with France's Thales Group. A smooth flight for EADS and Airbus? Not likely. ■

—By Carol Matlack in Paris

Checklist for Airbus' New Pilot

NAVIGATE treacherous dispute with U.S. over aircraft subsidies

KEEP A380 megaplane on track for 2006 launch

REV UP development of midsize A350 jet

SALVE wounds from leadership struggles at Airbus and parent company EADS

Data: BusinessWeek

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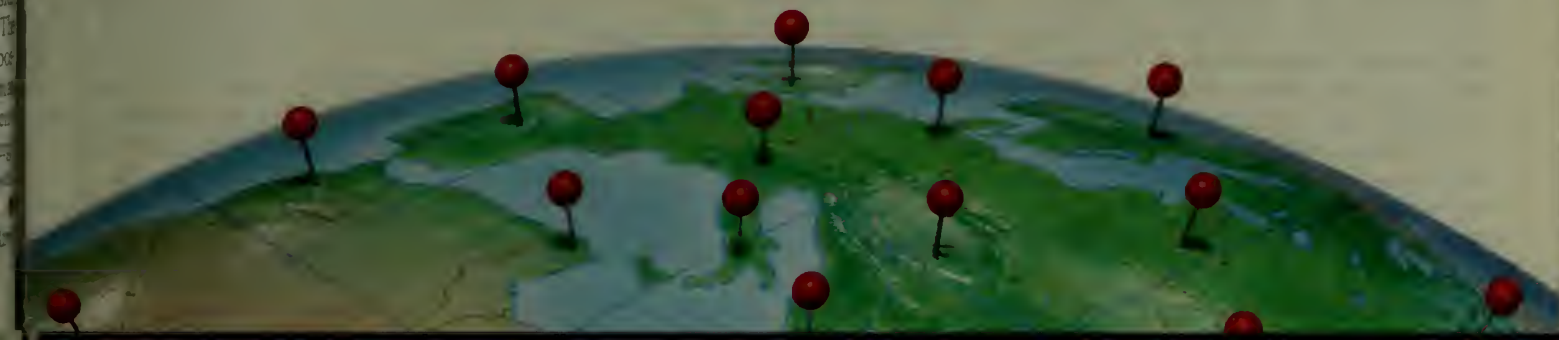


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INDIA

HERE COME THE WAL-MART WANNABES

As Indians flock to giant stores, the Big Bazaar chain is in the lead for now



IT'S A SUNDAY AFTERNOON AT the Phoenix Mills shopping center in Bombay, and the crowds are crushing. The former textile mill is a chaotic sprawl of one- and two-story buildings that house 50-plus stores. In the center's open-air courtyard, vendors sell pizzas, popcorn, and *roti* bread from pushcarts. One establishment throbs with more activity than any other. Big Bazaar, the local version of Wal-Mart, is the modern Indian family's favorite store. It stocks everything from peanuts and avocados to mops and crockery. The ringing of the registers is constant. The crowds love it, as does Kishore Biyani, founder and chief executive of Pantaloon Retail (India) Ltd., which owns Big Bazaar and is India's largest retailer. "The mall of today is like the temple of yesterday, where people flocked on Sundays," he explains.

The retail revolution has finally hit India, after decades of being rebuffed by its traditional mom-and-pop neighborhood stores. But you won't find Wal-Mart

Stores Inc. or Carrefour here. Indian retail is still largely closed to foreign companies, so it's Biyani and his ilk who are profiting from the rapid growth of the mall-hopping Indian consuming class—105 million strong and swelling 10% a year. Retail stores and malls like Big Bazaar are expected to be 9% of the market by 2010, with sales of \$23 billion, up from \$6.4 billion last year.

There's plenty of room to grow. According to consultants KSA Technopak India, just 3% of India's \$180 billion retail business is based in shopping centers and big stores, vs. 20% in China and 80% in the U.S. The rest is fragmented, with 12 million tiny shops catering to the needs of 1 billion Indians. Yet 60% of India

is under the age of 30, and young Indians have an affinity for modern shopping. The country boasts 26 malls like Phoenix Mills, which will grow to 60 by December. The country's seven big retailers have 3 new stores under construction.

U-SHAPED AISLES

THE LEVEL OF COMPETITION will only increase once the government eases restrictions on foreign investment—expected to happen within the next two or three years. Pantaloon's Biyani is preparing a battle plan. The son of a family of Bombay-based textile traders, Biyani, 43, started with one store in Calcutta in 1997. Today he owns 52 stores in 19 cities with revenues projected at \$250 million for the year ending in June—up 90% over last year. In any future battle with foreign competitors such as Wal-Mart, Biyani thinks he has the advantage of knowing the Indian consumer. One trademark of his stores: winding, U- and C-shaped aisles that create corners for families to consult about purchases. "Indians like to shop in groups and find straight aisles insipid," he says.

Biyani now sells every variety of goods under three brands. His 13-outlet department-store chain is called Pantaloon. Then there is discount hypermarket Big Bazaar and supermarket chain Food Bazaar. By December, Biyani's stores will occupy 3 million square feet of retail space. Pantaloon's stock price has zoomed from \$5 a year ago to \$17 today.

Skeptical analysts worry that Biyani is expanding too fast. He's got strong local competition, too. The Tata Group's Westside department store chain is growing as fast as Pantaloon. Other competitors include Shoppers Stop and the RPG Group's Spencer's. But Biyani dismisses the worries. A rough-hewn entrepreneur himself, he has begun hiring experienced managers and accountants to drive expansion and manage inventory. There will be lots of new entrants to the business over the next

two years, he says, but "we will have made most of our mistakes by then." It's still early days in India's retail industry, and down the road there is bound to be a shakeout. But it's clearly going to be tough to push Kishore Biyani off the top of the retail mountain. ■

—By Manjeet Kripalan in Bombay

Retail Runup

Mom-and-pop shops still dominate in India, but sales at chain stores and malls are growing fast.

2004	2010
\$6.4 billion or 3% of total retail revenues	\$23 billion or 9% of total retail revenues

Data: KSA Technopak India

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BusinessWeek

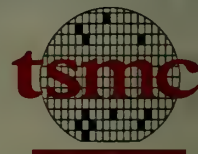


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Frying Times for Central Asia's Autocrats

IS ANOTHER AUTOCRATIC ex-Soviet leader about to fall? That's what some analysts are predicting after protesters occupied an airport and stormed government buildings in two major cities in the Central Asian nation of Kyrgyzstan on Mar. 20 and 21. The unrest was a reaction to disputed parliamentary elections held

in February and March, in which the opposition won just six seats in the 75-member parliament. International observers, including the Organization for Security & Cooperation in Europe, complained of voting irregularities. Now the opposition is demanding that President Askar Akayev, who has ruled the nation of 5 million since independence in 1991, step down.

Democracy or Chaos?

THE KYRGYZ PROTESTS are the first sign that the democratic revolutions that swept Georgia in 2003 and Ukraine late last year may be spreading to the strategically important region of Central Asia. That's a worry for Russian President Vladimir V. Putin, who is closely allied to Akayev as well as to the Soviet-era leaders of resource-rich Kazakhstan and Uzbekistan. Putin doesn't like international observers criticizing elections in his neighborhood. And Russia clearly fears a further erosion in its sphere of influence in Central Asia, where the U.S. established military bases for fighting the war on terror after September 11, 2001.

The stakes are also high because of the risk of ethnic conflict and Islamic militancy. The Kyrgyz protests have centered on the towns of Osh and Jalalabad in the south, where ethnic Kyrgyz, Uzbeks, and Tajiks have clashed in the past. Militant groups such as the Islamic Movement of Uzbekistan have used the region as a base, and the area is a transit point for opium trade. Moscow worries that unrest risks long-term instability. "In place of a moderate authoritarian, Akayev, there won't be democracy but chaos, which

will lead sooner or later to a radical Islamic dictator," says Sergei Markov, director of the Institute of Political Studies in Moscow.

How the current confrontation will play out is far from clear. Unlike the movements that led Georgia's "Rose Revolution" and Ukraine's "Orange Revolution," the Kyrgyz opposition is fragmented. As *BusinessWeek* went to press on Mar. 23, only small protests had broken out in the Kyrgyz capital, Bishkek. But the government warned that it would use force to prevent seizures of public buildings and other illegal actions. If violence escalates, civil war is possible. "There's a risk that this will be a very ugly situation," says Martha Brill Olcott, a Central Asia expert at the Carnegie Endowment for International Peace.



FEELING THE HEAT Kyrgyz protests threaten Akayev's rule

With an eye on Georgia, Ukraine, and now Kyrgyzstan, the region's autocratic leaders are tightening their grip. In Kazakhstan, where President Nursultan A. Nazarbayev plans to run for another seven-year term in 2006, a key opposition party has been banned. In Uzbekistan, President Islam A. Karimov has waged a crackdown after attacks blamed on Islamic militants last year.

In the short term, more repression may be an effective way for these leaders to quell opposition. But over time it could make matters worse. The deeper cause of discontent is political fossilization: Soviet-era leaders from Kyrgyzstan to Belarus are rarely willing to give up power. That may keep emboldening opposition figures to launch Rose, Orange, or Yellow Revolutions—as the Kyrgyz are calling theirs—whether intransigent elites or their Moscow allies like it or not. ■

—By Jason Bush in Moscow

GLOBAL WRAPUP

CHIRAC VS. THE EU: TENSION IS ON THE RISE

FRICITION IS growing between French President Jacques Chirac and some of his neighbors. At a European Union summit on Mar. 23, Chirac renewed calls for lifting the EU's arms embargo on China, even though other leaders recently backed away from ending the 15-year ban because of U.S. opposition and China's mounting pressure on Taiwan. Chirac also angered Britain by urging repeal of a long-standing arrangement that grants Britain a \$5.6 billion annual rebate on its EU budget contribution. At the same time, EU leaders are worried that Chirac's domestic woes could jeopardize Europe's proposed new constitution. Polls show that a majority of French voters may reject the constitution in a May 29 referendum, in what could be a protest vote against Chirac's government.

LITTLE PROGRESS ON NORTH AMERICAN TIES

THE LEADERS of Mexico, Canada, and the U.S. tried to put the best face on their Mar. 23 meeting at President George W. Bush's ranch. But deep divisions remain. In a press conference, Canadian Prime Minister Paul Martin dashed any hopes that Canada might cooperate in a ballistic missile defense system, a U.S. military priority. For his part, Bush promised neither a settlement of the decades-old dispute over alleged Canadian subsidies for softwood lumber nor an imminent lifting of the U.S. ban on Canadian beef imports. And he offered Mexican President Vicente Fox no assurances that Congress will back a proposed guest-worker plan for Mexicans. That left the three to herald an expanded program to facilitate trade by simplifying customs procedures.

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Stars that fell: A look at some familiar names that didn't make the cut.

S&P fund managers John Wallace and Jay Sherwood see green in companies that are in the red.

Instead of chasing dividends, consider tech companies with strong balance sheets, says S&P analyst Scott Kessler.

The sky's the limit—or is it? Tech valuations are soaring, buyer beware.

Plus, Q&A's with Autodesk's Carol Bartz, Yahoo's Dan Rosensweig, Nucor's Dan DiMicco, and Dow's William Stavropoulos.

www.businessweek.com/bw50

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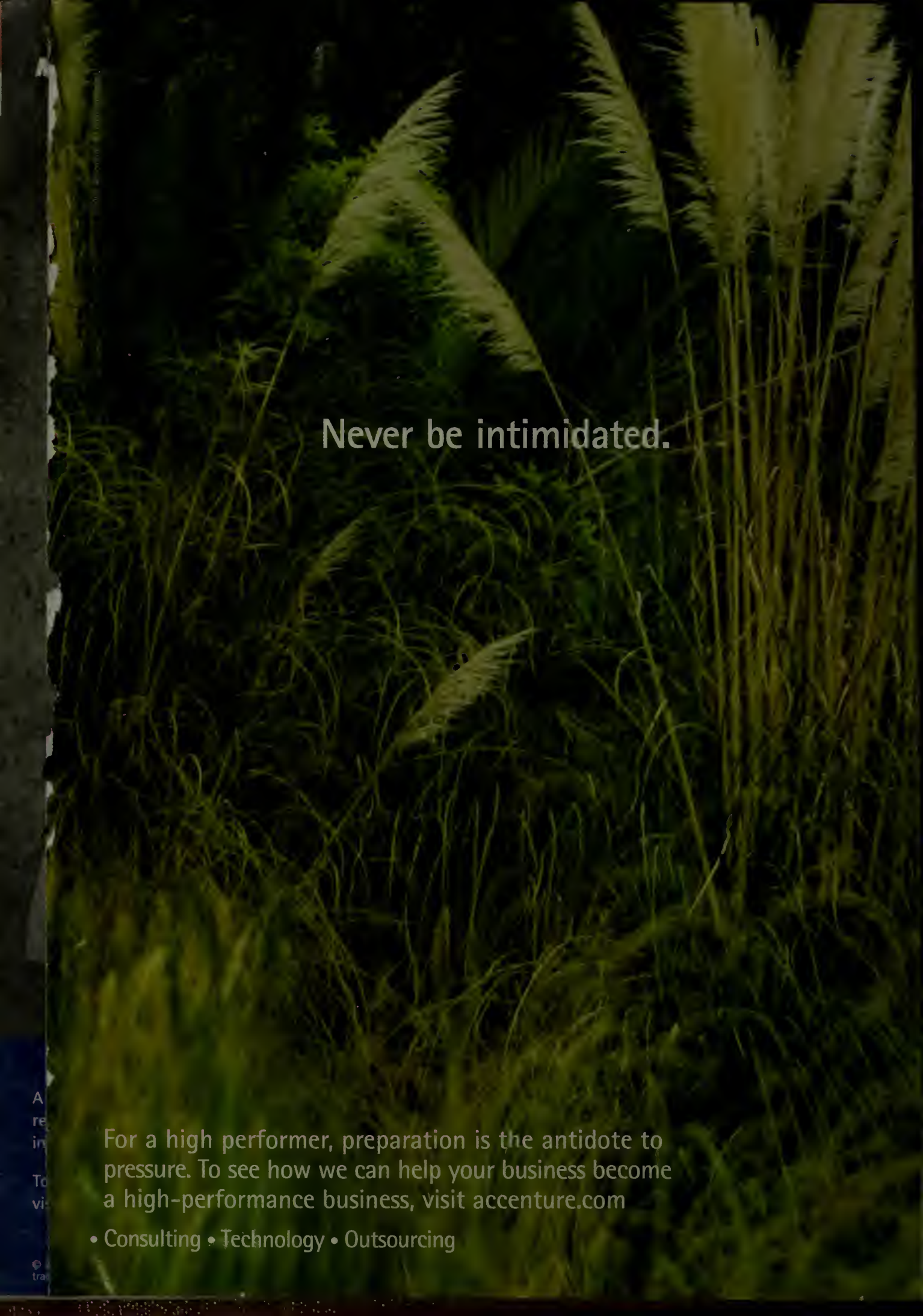
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A 163-year-old brand with many owners over the years, Thomas Cook UK & Ireland was a respected but complex decentralized travel services business in need of a return to profitability. In an innovative co-sourcing arrangement with Accenture, the company created a shared services center to consolidate its widely dispersed IT, finance and HR administration operations. Responsibility for strategy and policy was retained by Thomas Cook, with Accenture facilitating operations management. In 16 months, the company removed £140 million in operational costs, helping to achieve an £83 million turnaround, establishing Thomas Cook as a high-performance player in the competitive UK travel business.

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A full-page photograph of a golfer in mid-swing, wearing a white shirt, dark pants, and a white cap. The golfer is positioned in the lower right quadrant of the frame. The background is a dense field of tall, golden-brown grasses that fill the upper two-thirds of the image. The lighting is soft, creating a warm, golden tone across the scene.

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The BEST Performers

2005 This year's list is the most diverse in the ranking's history. Heavy industry and oil make a strong showing. So do technology, consumer brands, health care, and others. Check out the latest *crème de la crème*

HAVEN'T HEARD OF PACCAR Inc.? You've surely seen the company in action—its Peterbilt and Kenworth trucks are some of the most popular brands on America's highways. And thanks to a growing need to replace aging fleets and increased willingness by business to spend, the truckmaker's profits are barreling ahead as well: Net income last year surged 72%, to \$906.8 million. Shareholders couldn't be happier: PACCAR delivered 41% returns for the year ended Feb. 28, and 159% over the past three years.

While there's no doubt the economic cycle has finally swung the way of the Rust Belt, there's a

ot more to PACCAR's stellar results than just good timing. The Bellevue (Wash.) company has produced profits in each of the past 65 years, despite the highly cyclical nature of the trucking industry. Management is constantly on the lookout to control the company's costs, through modest hiring in good times and selective capital investment at all times. A reputation for quality allows PACCAR to demand premium prices for its brand-name vehicles. That, as much as any economic upswing, explains why the company landed a spot on the 2005 BusinessWeek 50, our ninth annual ranking of the best-performing companies in the Standard & Poor's 500-stock index.

This year's version of the BusinessWeek 50 has an unprecedented touch of gray. Joining PACCAR on a strikingly varied list are a slew of the most ef-

mmers

AR efficiently run players from heavy industry, such as the minimill steelmaker Nucor Corp.—this year's No.1 company—and farm- and construction-equipment manufacturer Caterpillar Inc. Surging commodity prices helped big oil companies win six of our top 10 spots, in fact. But this year's list isn't all diesels and smokestacks. Technology companies show up in numbers unseen since the boom days. Stalwarts Cisco Systems and Microsoft return after a yearlong hiatus to make their fifth and sixth appearances on the list, respectively. Internet stars eBay and Yahoo! are repeat performers. Add in some powerful consumer brands, from luxury (Coach) to lattes (Starbucks); consumer-service powerhouses such as FedEx and Progressive; and two of the most successful conglomerators of health care, United-

- 1 Nucor
- 2 ConocoPhillips
- 3 ChevronTexaco
- 4 Valero Energy
- 5 UnitedHealth Group
- 6 Occidental Petroleum
- 7 ExxonMobil
- 8 Yahoo!
- 9 Nextel Communications
- 10 Apache
- 11 Devon Energy
- 12 Pulte Homes
- 13 Qualcomm
- 14 Apple Computer
- 15 Dell
- 16 PACCAR
- 17 Coach
- 18 Sunoco
- 19 eBay
- 20 Burlington Resources
- 21 Progressive
- 22 Caremark Rx
- 23 Caterpillar
- 24 Phelps Dodge
- 25 Autodesk
- 26 Johnson & Johnson
- 27 Carnival
- 28 Adobe Systems
- 29 Cummins
- 30 Boston Scientific
- 31 EOG Resources
- 32 Symantec
- 33 Starbucks
- 34 Electronic Arts
- 35 WellPoint
- 36 Deere
- 37 United States Steel
- 38 Zimmer Holdings
- 39 FedEx
- 40 Chubb
- 41 XTO Energy
- 42 Microsoft
- 43 Danaher
- 44 Unocal
- 45 Dow Chemical
- 46 Cisco Systems
- 47 Gilead Sciences
- 48 Nike
- 49 Anadarko Petroleum
- 50 Bank of America

Data: Standard & Poor's Compustat

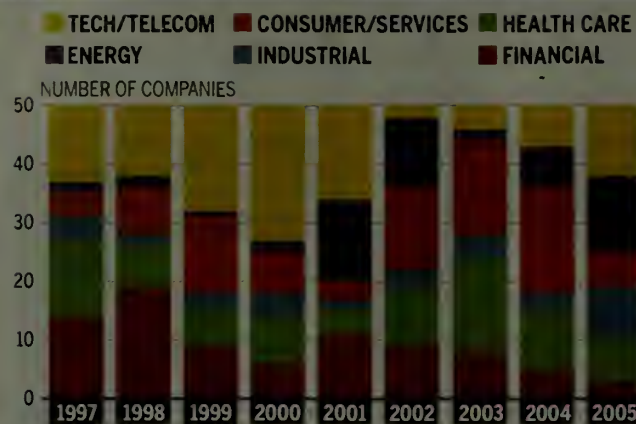
Health Group and Wellpoint.

In fact, the 2005 roster of BusinessWeek 50 companies is the most diverse in the ranking's history (chart). As heavily represented as energy companies are, they still show up in only 13 of the 50 slots. The strong growth across several sectors is no accident: "It's a mirror of ... the U.S. economy right now, in the sense that what we're seeing is broad, moderate growth," says Steven Wieting, senior U.S. economist at Salomon Smith Barney.

Not So Frothy

THAT'S IN SHARP CONTRAST to the roaring '90s, when tech companies posted gains that far outdistanced most other industries. Without one high-flying sector to spur major economic innovation, there's less of the dynamism, energy, and froth in the economy and the markets than in the boom years. But most economists are willing to make that trade-off, since it

EVOLUTION The 50 through the years



Data: Standard & Poor's Compustat

reduces the chance of a bubble—and its concomitant bursting. "When you have balance to things, it gives you a better chance to sustain a strong environment," says Prudential Securities Chief Economist Richard D. Rippe.

That sustainability may even pertain to commodity-driven companies, such as back-from-the-dead U.S. Steel, copper miner Phelps Dodge, and oil refiners such as Sunoco, all of which made our list. Demand from the developing world, most notably China and India—isn't likely to slack

soon. And since it takes a while for commodity supplies to ramp up, years will pass before supply catches up with demand and prices ease, argues Rajeev Dhawan, director of the Economic Forecasting Center at the Robinson College of Business, Georgia State University. "You can have this dominance of commodity-based companies continuing for a few more years," Dhawan says.

THE BEST AND WORST OF THE S&P 500 COMPANIES

EARNINGS Best and worst earnings performances in the S&P 500

TOP TEN (ONE-YEAR)	PERCENT CHANGE	TOP TEN (THREE-YEAR)	PERCENT CHANGE	BOTTOM TEN (ONE-YEAR)	PERCENT CHANGE
Phelps Dodge	5681%	Devon Energy	449.7%	Viacom	-\$15,059.1
Symbol Technologies	2379	ACE	285.7	AT&T	-6110.1
Robert Half International	2100	Ford Motor	257.7	Delta Air Lines	-5198.1
Nucor	1686	Prudential Financial	194.4	Corning	-2185.0
Monster Worldwide	1013	Yahoo!	180.2	Tenet Healthcare	-1797.0
OfficeMax	1008	Veritas Software	167.8	Qwest Communications	-1794.0
Avaya	989	Raytheon	151.9	Visteon	-1489.0
Transocean	727	Chubb	150.5	Sprint	-1012.0
National Semiconductor	598	Lockheed Martin	146.0	Schering-Plough	-947.0
Pfizer	596	Electronic Arts	138.2	Ciena	-769.8

TOTAL RETURN The best and worst in shareholder returns among the S&P 500

TOP TEN (ONE-YEAR)	PERCENT CHANGE	BOTTOM TEN (ONE-YEAR)	PERCENT CHANGE	TOP TEN (THREE-YEAR)	PERCENT CHANGE	BOTTOM TEN (THREE-YEAR)	PERCENT CHANGE
Apple Computer	275.1%	Ciena	-65.4%	Nextel Communications	489.8%	Delta Air Lines	-86.4%
TXU	176.2	JDS Uniphase	-60.5	Yahoo!	346.3	Dynegy	-83.6
Valero Energy	139.2	Sanmina-SCI	-56.6	Coach	345.5	Ciena	-74.5
Autodesk	107.2	Power-One	-52.5	Provident Financial	340.9	Tenet Healthcare	-71.7
Rockwell Automation	107.2	King Pharmaceuticals	-50.4	Aetna	317.3	Siebel Systems	-69.3
EOG Resources	105.6	PMC-Sierra	-50.0	Apple Computer	313.5	King Pharmaceuticals	-69.3
Nucor	100.5	Novell	-48.5	XTO Energy	308.9	El Paso	-64.9
Williams	100.0	Delta Air Lines	-48.3	United States Steel	262.0	Micron Technology	-64.2
Allegheny Technologies	96.6	Applied Micro Circuits	-46.7	Countrywide Financial	249.0	Electronic Data Systems	-61.3
XTO Energy	91.4	Unisys	-45.6	Valero Energy	242.3	JDS Uniphase	-60.6

Data: Standard & Poor's Compustat

Last year, for the first time in years, the BusinessWeek 50 basket of stocks outpaced the S&P 500. Shares of the companies on the 2004 list, considered as a whole, advanced 10.6% over the 12-month period ended Mar. 14, compared with a slight 2.9% increase for the S&P and a -1.5% dip for the NASDAQ Composite Index. The BusinessWeek 50 is at heart a growth-stock list. Naturally in a rising economic environment, that bias toward profit and sales increases tends to outperform the broader market indexes.

Our proprietary formula yields a varied group of companies with wildly different risk profiles. Take a look at Robert Barker's column (page 82), where he dishes out tips for all types of investors, from the strong of stomach to the faint of heart. You can find even more investing advice at BusinessWeek Online.

With such a varied list of winners, there is bound to be a

METHODOLOGY How we measured the top 50

EVOLUTION HAS BEEN A HALLMARK of the BusinessWeek 50 ever since we created the ranking back in 1997. One of our goals was to capture the dynamic nature of strong growth. It's reflected in how we identify the best of the S&P 500. We use 10 performance metrics, starting with sales and earnings growth. We tally both for the most recent 12-month and three-year periods, to reward companies that can prosper over time. As a gauge of how well management deploys its resources, we factor in net profit margins and return on equity. And finally we account for the market's view, by measuring total shareholder returns for one- and three-year periods.

We weight the results for sales volume, because it's harder for large companies to post impressive revenue- and profit-growth figures. And we factor in the debt-to-capital ratio, to recognize clean balance sheets. That also makes it harder for corporations to qualify with growth that's primarily the result of debt-laden acquisitions.

an ability to deliver results. Following that are snapshots of each BusinessWeek 50 company. And we complete our package with information-packed tables, laying out performance rankings for each of the companies in the S&P 500, arranged first by industry group, and second alphabetically. Dig in. ■

—By Brian Hindo in New York



SALES GROWTH The best and worst in sales performance among the S&P 500

TOP TEN (ONE-YEAR)	PERCENT CHANGE	BOTTOM TEN (ONE-YEAR)	PERCENT CHANGE	TOP TEN (THREE-YEAR)	PERCENT CHANGE	BOTTOM TEN (THREE-YEAR)	PERCENT CHANGE
Biogen Idec	225%	Williams	-25%	Biogen Idec	97.3%	El Paso	-38.7%
Caremark Rx	185	Citizens Communications	-14	Gilead Sciences	79.0	Ciena	-35.3
Applied Micro Circuits	128	Sears Roebuck	-12	ConocoPhillips	74.1	Allegheny Energy	-34.9
Yahoo!	119	AT&T	-12	Yahoo!	70.6	JDS Uniphase	-30.1
Nucor	82	Washington Mutual	-11	eBay	64.9	CINergy	-25.7
Phelps Dodge	71	CMS Energy	-10	Caremark Rx	62.6	ADC Telecommunications	-23.9
Donnelley (R.R.)	71	Mylan Laboratories	-9	Constellation Energy Group	52.8	Lucent Technologies	-23.3
OfficeMax	68	Huntington Bancshares	-8	Valero Energy	51.4	Provident Financial	-22.7
Applied Materials	65	Exelon	-8	Devon Energy	49.6	CenterPoint Energy	-21.1
XTO Energy	64	Loews	-8	Sanmina-SCI	44.9	Penney (J.C.)	-20.2

NET MARGIN Best/Worst, S&P 500

TOP TEN (2004)	PERCENT	BOTTOM TEN (2004)	PERCENT
Ambac Financial Group	51.7%	Ciena	-235.4%
Kinder Morgan	45.4	Viacom	-66.9
SLM	43.8	Corning	-56.7
Linear Technology	41.1	Applied Micro Circuits	-52.4
MBIA	40.4	Delta Air Lines	-34.6
ProLogis	38.8	LSI Logic	-27.3
Novell	37.2	AT&T	-20.0
Qualcomm	36.1	Tenet Healthcare	-18.1
PG&E	34.5	Gateway	-15.6
MGIC Investment	34.3	Teco Energy	-15.2

RETURN ON EQUITY Best/Worst, S&P 500

TOP TEN (2004)	PERCENT	BOTTOM TEN* (2004)	PERCENT
UST	5625.2%	Visteon	-343.1%
Moody's	288.2	Gateway	-235.1
AutoZone	204.4	Tenet Healthcare	-103.8
IMS Health	144.6	AT&T	-82.8
Colgate-Palmolive	104.5	Ciena	-70.1
Avon Products	89.0	Corning	-57.3
Anheuser-Busch	84.0	Interpublic Group	-36.2
Dow Jones	81.7	Teco Energy	-31.5
SLM	61.3	LSI Logic	-28.7
Gillette	59.6	Viacom	-23.7

Data: Standard & Poor's Compustat

*Excludes companies with negative equity

NUCOR

Soaring on Wings of Steel

DANIEL R. DiMICCO BEGAN SNAPPING UP VINTAGE 1960s Corvettes a few years ago. But his wife balked when his collection, seven cars strong, began to outgrow their garage. “The deal with my wife now is that if I get a new one, I have to get rid of another,” he laments. DiMicco has no such restrictions at work. And in recent years, the 54-year-old CEO of Nucor Corp.—the Charlotte (N.C.) pioneer of the minimill approach to steelmaking—exploited the downturn in steel earlier this decade with a whirl of deals.

While his predecessors at Nucor had long taken a go-it-alone strategy, DiMicco has spent more than \$1.1 billion since 2001 to snatch up 10 steel plants on the cheap—even scooping up Birmingham Steel Corp. and Trico Steel Co. out of bankruptcy. DiMicco’s timing may have been shrewd: The buyer’s market in steel enabled Nucor, the only U.S. steelmaker to remain profitable during the downturn, to snap up more than 5 million tons of annual production capacity for an average of 17¢ on the dollar.

Up from Scrap

THE RESULT: WHEN GLOBAL steel prices began to rebound last year—the result of tight supply and a construction boom in China—DiMicco’s acquisition spree paid off big. Nucor’s profits soared seventeenfold, from the \$62.8 million earned in 2003 to \$1.1 billion last year—a dramatic surge that earned Nucor the top spot in this year’s BusinessWeek 50. While soaring steel prices helped, analysts give DiMicco credit for positioning his company to benefit from the consolidation of the steel industry. “Nucor has done a better job of navigating through an extraordinarily difficult time than any other cyclical company I’ve ever seen,” says Lewis Johnson, an analyst at T. Rowe Price Associates, which holds 8.7 million Nucor shares.

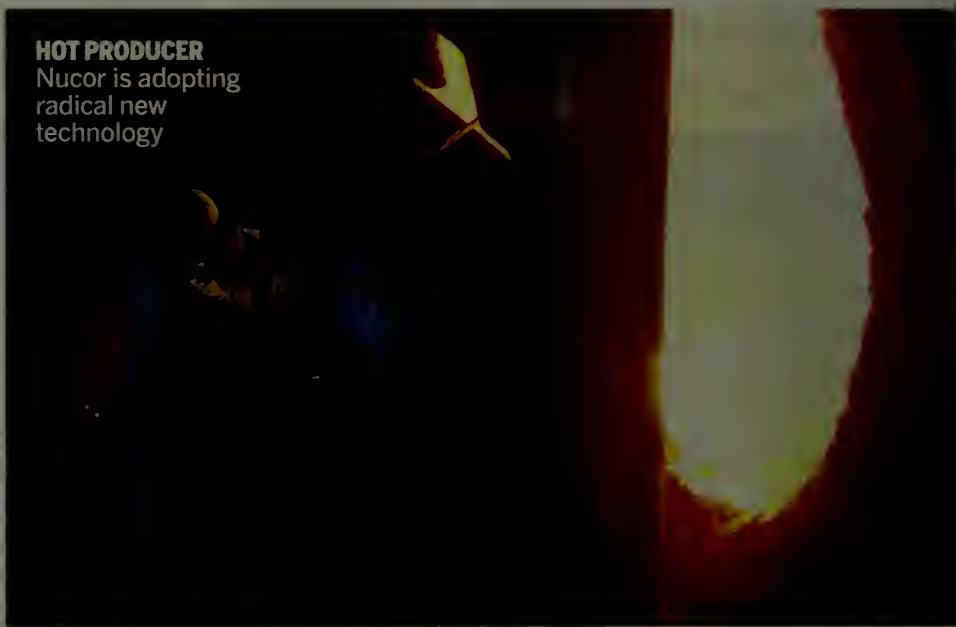
For Nucor, the rise to become the world’s 10th-largest steelmaker was an improbable journey. Once a maker of nuclear testing equipment, Nucor expanded into making steel joists in the 1960s. Frustrated over the chronic steel shortages of the

time, then-CEO F. Kenneth Iverson built his own minimill adopting an experimental technology that used electric arc furnaces to melt scrap metal—a much cheaper raw material than iron ore—into finished steel. As Nucor expanded its steel operations, using nonunion workers, to produce for other customers, the company gradually gained ground on the big integrated mills that were saddled with expensive union contracts.

Today, DiMicco is rolling the dice again on technology to help Nucor leapfrog the competition. After nearly three years testing, Nucor recently began round-the-clock production at Indiana plant using a radical new process known as “strip casting,” in which steel is extruded through a nozzle into thin strips of metal that are practically ready for market. If that bet pays off, it could give Nucor a huge cost advantage over traditional steelmakers, who produce thick metal slabs that must painstakingly be rolled into sheets. “Nucor is going to revolutionize the way steel is made again,” boasts DiMicco.

Until then, some wonder if Nucor will stay hot. Christopher D. Olin of Longbow Research in Independence, Ohio, expects steel prices—which have already fallen as much as 15% in some categories since last fall—to dip further as the panic buying thins.

HOT PRODUCER
Nucor is adopting radical new technology

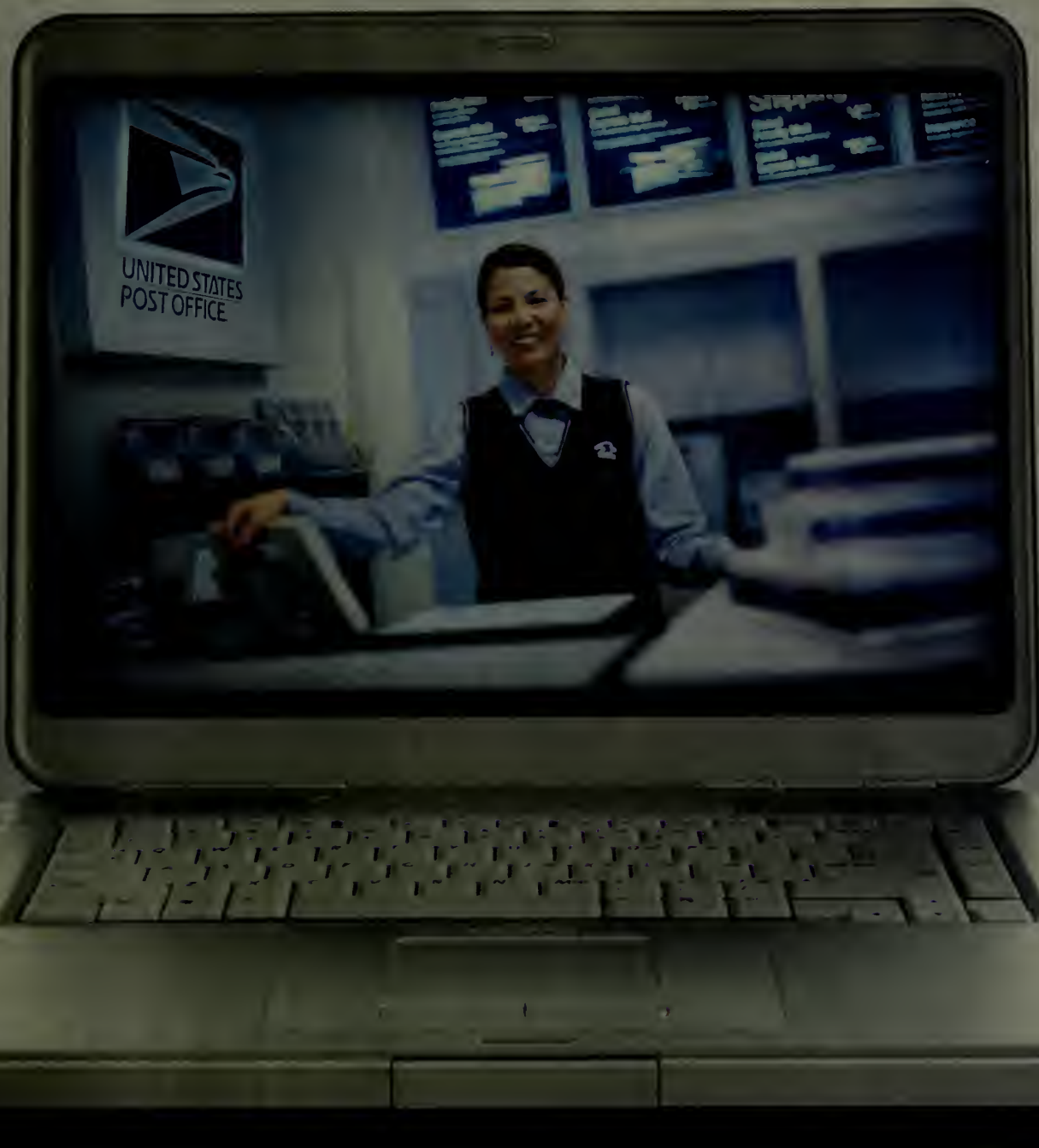


ADVANTAGE Nucor snapped up 10 mills during the downturn and is now reaping the benefits from high steel prices

sent prices up wanes. DiMicco says Nucor has been able to preserve margins thanks to an even-greater dip in scrap metal.

DiMicco has been vocal in his calls for Washington to protect U.S. steelmakers better from illegal dumping by foreign competitors. At the same time, he believes resolutely that because of his acquisition spree, Nucor now has the bulk to compete on the global stage. “Our best years are still ahead of us,” he says. And DiMicco does have an eye for value. ■

—By Dean Foust in Charlotte, N.C.



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STRATEGIES: AUTODESK

A Software Vet's
Growth Spurt

FOR A SOFTWARE COMPANY, SURVIVING more than 20 years is a feat in itself. But computer design stalwart Autodesk Inc. isn't creaking along these days—it's thriving. The secret: It has consistently come up with ways to rejuvenate and adapt its core product, AutoCAD. A reinvention of its sales model and aggressive moves into red-hot overseas markets have also propelled Autodesk—the second-oldest PC software company, behind Microsoft—to No. 25 on the BusinessWeek 50.

As companies adopt its array of software to design buildings, bridges, roller coasters, and other structures, Autodesk has reemerged as one of Silicon Valley's most unlikely success stories. Last year, Autodesk's profits almost doubled, to \$222 million, and sales increased 30%, to \$1.2 billion. While most software companies struggled to regain Wall Street's confidence, Autodesk's torrid growth helped triple its stock to \$38, though it has cooled this year. And on Mar. 15 it launched a new set of products that should stoke the comeback, say investors, analysts, and company execs. "There's a lot of irons in the fire, and that will beget even better results down the road," says Dan Hanson, an analyst with Merrill Lynch Investment Managers, which owns 1.9 million shares of Autodesk.

Designing Productivity

AUTODESK HAS LONG DOMINATED design software—an important market, but one modest enough to avoid forays from heavies such as Microsoft. Five years ago, with its sizable lead in architecture and engineering software in place, Autodesk began a diversification strategy, with new divisions that crafted programs for specific industries such as manufacturing, infrastructure, and entertainment. Last year those divisions accounted for about half of its sales. "Our idea is to democratize this software for all-size companies so they can get productive," says Chairwoman and Chief Executive Carol A. Bartz.

Customers say that Autodesk is backing up its promises. Phil Steiger, senior network administrator for Energy Absorption Systems Inc., a Chicago-based maker of guard rails and other highway safety devices, says he's particularly fond of Autodesk's new software that lets engineers mock up 3D designs. The program automatically draws images into two dimensions and lets several people work on one product at the same time. Now products are getting to market 25% quicker. "If we didn't have Autodesk we couldn't do our job," says Steiger.



DESIGN MASTER
A rendering created
in AutoCAD

BLUEPRINT Now 23 years old,
Autodesk has diversified its lines and
moved into red-hot markets abroad

Like much of the industry, Autodesk moved toward a subscription sales model about four years ago. Steiger used to buy about 20 new versions of the software every five years at about \$6,500 a pop. Starting two years ago, he began paying \$1,000 per license per year, saving \$30,000 over five years. And now that his engineers get annual releases instead of upgrading every five years, it takes them only a few hours to learn the new version rather than a week or two of off-site training. Autodesk benefits as well: Subscriptions, now 17% of total sales, are "a stable revenue stream for our investors," says CEO Bartz.

Targeted investments in overseas markets have helped boost the company, too. Autodesk has been operating in China for 10 years, but in 2003 it opened a new development center in Shanghai. Last year it launched a wholly owned subsidiary to focus more on building software tailored to the Chinese market. Asia Pacific was Autodesk's hottest market last year, growing 36% compared with 25% growth in the Americas.

Looking ahead, Bartz is confident that Autodesk can continue to innovate and enable companies to ride the global manufacturing wave. Only 15% of its customers have upgraded to more-profitable 3D programs, and nearly 90% of beta users surveyed said they will upgrade to the new release. "We're at the beginning of a great run," says Bartz. In the technology industry, sometimes you can teach an old dog new tricks. ■

—By Spencer E. Ante in New York

STRATEGIES: EXXONMOBIL

The Cautious King Of the Oil Patch

DON'T EXPECT RECORD OIL PRICES AND PREDICTIONS of permanently tight supplies to change the course of Exxon Mobil Corp. The largest publicly traded oil giant hasn't produced industry-leading returns in booms and busts by zigzagging with every price change. "Focus and discipline are even more important in these buoyant industry conditions," Chief Executive Lee R. Raymond told analysts on Mar. 9.

For some companies, boom times can be as damaging as busts if they make poor short-term decisions. But Exxon excels through all phases of the commodity cycle. Surging oil and natural gas prices and robust refining margins factored into last year's record \$25.3 billion in net income and a leading 24% return on capital employed. But the company's stringent investment criteria, cost controls, and \$600 million spent on research and development played a big role, vaulting Exxon to No. 7 on the BusinessWeek 50, from No. 23 in 2004. "Their business model is not predicated on any specific oil price," says analyst Fadel Gheit of Oppenheimer & Co. "They will still be the head of the class, no matter how difficult the exam."

Tough Negotiator

TRUE TO FORM, Exxon's staggering cash flow hasn't led to a gusher of new projects. The company generated more than \$43 billion last year from operations and asset sales. But it returned some \$15 billion to shareholders in the form of dividends and share buybacks—as much as it invested in capital spending. Raymond insisted that the company is not "opportunity constrained," a view held by some analysts. But, he said, "only those projects we are confident will grow shareholder value make the grade." Every investment decision at Exxon greater than \$50 million goes before the management committee. Raymond declined to be interviewed.

Still, at Exxon's size, with \$271 billion in revenues last year, only megaprojects such as its \$7 billion gas-to-liquids foray in

Qatar are big enough to affect the company's bottom line. And the company is famous for being a tough negotiator in such places as Russia and Venezuela, where it insists that projects reap healthy profits no matter where oil prices head. Smaller oil companies, meanwhile, are increasingly willing to spend more and to sacrifice returns to win drilling opportunities. "There's not a country in the world that we just have to have a presence in," President Rex W. Tillerson told analysts.

Exxon is cautious partly because its leaders aren't convinced high oil prices are here to stay. Raymond recalls the devastating oil price collapse of 1985, when prices fell to \$10 a barrel following predictions that they would hit \$100. "It's hard to identify any single commodity that has ever maintained a very high price over a very long period of time," he told analysts.

The company can afford to be patient. With a diverse resource base equivalent to 73 billion barrels of oil and exploration rights in more than 30 countries, "Exxon is already sitting on top of a very large pool of potential development," says analyst Robert A. Kessler of investment bank Simmons & Co. Exxon's proven reserves, 22.2 billion bbl., could sustain 14 years of production at current rates. Excluding acquisitions, Exxon by 2011 will be one

LNG TERMINAL
One of several
ExxonMobil
projects in Qatar



SELECTIVE With its wide resource base, ExxonMobil doesn't sacrifice returns to win new drilling opportunities

of the few majors to exceed its volumes today, predicts Kessler.

Analysts do expect one major change at Exxon later this year: the retirement of Raymond and the likely ascension of Tillerson, 52, to the top post. The company won't talk about its succession plans. But in true Exxon style, few expect a leadership switch to make a difference. "Exxon is a machine. It has been operating well for over 100 years," says Kessler. The job of Raymond's successor? Simply keep this machine humming. ■

—By Wendy Zellner in Dallas

STRATEGIES: **YAHOO!**

Exporting An *Uber*-Brand

JERRY YANG AND DAVID FILO COULDN'T have realized their branding genius when they dubbed their pip-squeak Web site "Yahoo!" a decade ago. The offbeat moniker helped build the company's image as an approachable place for a fun Internet experience. And it has become a rock-solid brand that has helped Yahoo Inc. keep growing, amid industry turmoil and competition from rivals as disparate as upstart Google and behemoth Microsoft. "The brand has never been more important than it is today," says Cammie Dunaway, Yahoo's chief marketing officer.

Now, with more than two-thirds of U.S. adults plugged into the Net, the challenge for Sunnyvale (Calif.)-based Yahoo is to build its brand overseas, becoming a truly global player just as markets such as China and India begin to make good on their staggering growth potential. Already, Yahoo's business from international markets rocketed 241% in 2004, triple the rate in 2003. That helped sales rise 120%, to \$3.6 billion, while net profits spiked 253%, to \$840 million—good enough to bump Yahoo to No. 8 on the BusinessWeek 50, from No. 27 last year.

The clout of Yahoo's brand has grown almost as quickly as its stock price. Consulting firm Interbrand Corp. last year figured that the value of Yahoo's brand had grown 17% from the prior year, to \$4.6 billion, the third-highest climb among the top 100 companies that Interbrand tracks. "Part of Yahoo's success is that they've stuck to their knitting," says Hayes Roth, vice-president for marketing at branding consultants Landor Associates. "The brand itself is very approachable."

Wacky Vibe

IT'S STILL UNCLEAR HOW WELL the brands of U.S. Net giants will fare in developing countries. Sure, Yahoo and its U.S. competitors have become top destinations from Hong Kong to France. But in countries where Internet growth is expected to explode, the U.S. behemoths are still establishing themselves. In China, for one, where Net penetration rates are still well below 10%, Yahoo and Google promote their own sites while also acquiring or investing in regional Internet operations. In 2003, Yahoo acquired Hong Kong search firm 3721 Network Software, while Google invested in Chinese search company Baidu last year.

What's clear, though, is that Yahoo's efforts will revolve around extending its own core brand. To achieve this, Yahoo hopes to emanate the same wacky vibe that pervades its yodel-filled domestic ads. The key, says Dunaway, is to do things no-



NEW PORTAL Yahoo promotes its site in China

WILL IT TRANSLATE? The challenge is to establish Yahoo in foreign markets where Net use is expected to explode

body has done before, often with an edgy approach. In Taiwan, Yahoo launched an ad campaign where users gleaned clues of the Web and billboards to discover who got a fictional supermodel pregnant. And in France, Yahoo hosted late night evenings at supermarkets where singles could pick up a Yahoo purple basket to demonstrate their willingness to meet someone. "You have to work hard...to engage [customers] in your marketing," Dunaway says.

Yahoo's tack differs from many of its Net competitors. The company attaches its moniker to virtually everything it does, be it Yahoo! Mail, Yahoo! Shopping, or Yahoo! Autos. And it intertwines its various services with links throughout its sites. By contrast, Google tends to hatch stand-alone brands, such as its e-mail service (Gmail), online shopping service (Froogle), or social-networking site (orkut). And the amount of so-called cross-linking it does between services is minimal.

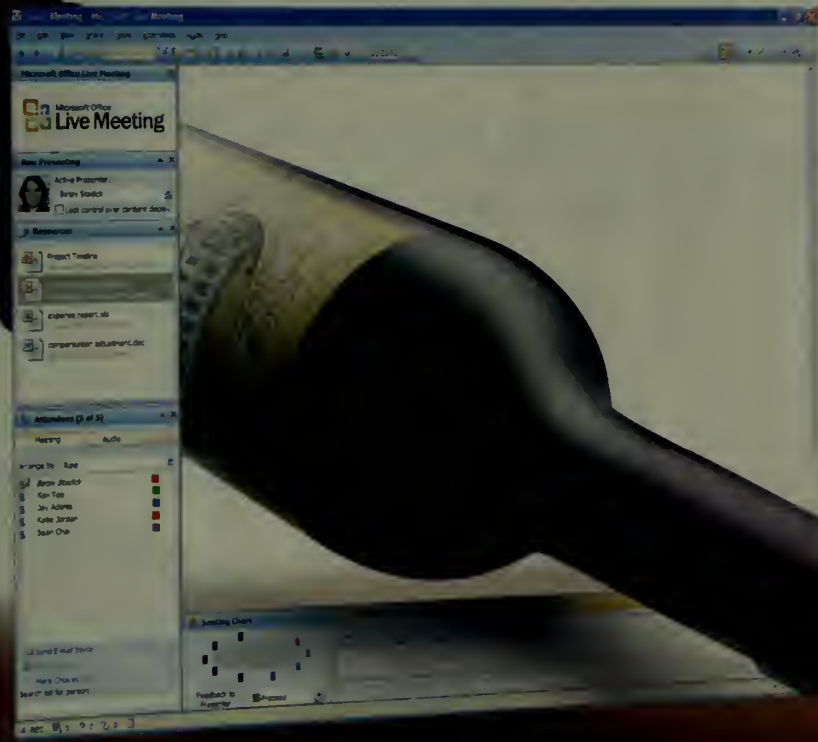
The *über*-brand approach creates a veritable Internet theme park. The longer users stay on the site, the closer the relationship they develop with Yahoo—and the more likely they are to subscribe to a service or make a purchase. Take, for instance, online shopping. Yahoo! Shopping has been around several years longer than Google's. Just as important, Yahoo prominently features its shopping engine throughout its site, from search results to links on its home page. Froogle, only recently woven into Google's other pages, has struggled to gain traction. Yahoo! Shopping boasted 10 times more visitors than Froogle in January, says researcher comScore Media Metrix.

In the end, though, the quality of Internet products—whether search engine or e-mail service—will make or break the company's efforts to stay on the crest of the Web wave. Every new would-be offering must survive a grueling gauntlet, requiring sign-offs from marketers and technologists—and often CEO Terry S. Semel himself. Says Dunaway: "What hasn't changed is that great products still equal a great brand." So far, Yahoo has largely adhered to that verity. ■

—By Ben Elgin in San Mateo, Calif.

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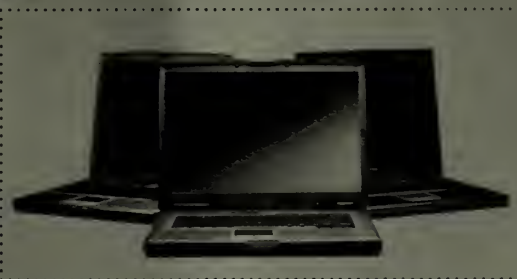
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STRATEGIES: **DOW CHEMICAL**

This Time, Dow Gets Its Man

BACK IN LATE 2000, WILLIAM S. STAVROPOULOS installed his successor, completing what he thought was his final and perhaps most enduring job as chief executive of Dow Chemical Co. He was wrong. As careful as Stavropoulos had been in selecting 32-year Dow veteran Michael D. Parker, the company quickly foundered. Parker—groomed during boom times—ordered layoffs, but was slow to cut spending. Dow swung from seven consecutive years of profits to back-to-back losses. Parker was sacked, and Stavropoulos, who had moved on to chairman, was back in his old office.

Now, Stavropoulos has stepped down again. He's still chairman, but he turned over the CEO post last fall to another Dow lifer, Andrew N. Liveris. This time, the new guy, who's already built a reputation for his tightfisted ways, looks like he'll keep the job. "Stavropoulos left large shoes to fill," says Kevin W. McCarthy, an analyst with Banc of America Securities. "Liveris seems to be up to it."

Revolving Door

DESPITE THE BEST intentions of boards, the executive suite often has a revolving door. At least once a week, on average, a company in the Standard & Poor's 500-stock index gets a new chief. Including Dow, five BusinessWeek 50 companies got new bosses in 2004. But Corporate America doesn't always get it right. "The person they have might be ideal if the company's in a static environment," says Marc S. Efron, who heads the leadership consulting practice at Hewitt Associates Inc.. "But how many companies are really in a static environment?"

Certainly not Dow, No. 45 on the list. When Parker became CEO, the industrial economy was sinking into its worst recession in a generation. Moreover, Dow had just completed a \$11.6 billion takeover of Union Carbide Corp.—its biggest ever—which weighed the Midland (Mich.) company down with debt. Today, the cycle has shifted drastically: Demand for Dow's chemicals and plastics is rising worldwide.

The difference between this hand-off and the last one is more than a matter of timing, however. Parker, who is now CEO of British Nuclear Fuels PLC and declined to be interviewed, was

slow to react to the downturn, say analysts and Dow executives. Within weeks of retaking control, Stavropoulos ordered a pay freeze and began targeting plants for shutdown. He also launched a search for a successor. Before, the board left the hiring pretty much up to Stavropoulos and the search committee. This time, every director interviewed each of three finalists, quizzing them about how they would get the most from Dow's assets and money. Detailed answers were required in writing.

After five months of scrutiny, the board went with Liveris, an Australian who had joined Dow in Hong Kong in 1976 and had risen to president of Dow's performance chemicals unit. But Liveris didn't go straight to the corner office. He was promoted first to chief operating officer, in late 2003. The board also spelled out his duties on paper so that directors could evaluate his progress. Liveris hasn't fiddled around. He ordered price hikes to offset soaring raw-material costs and announced another round of mass layoffs. Liveris also sought advice from as many people as he could—by his count, he met with more than 60 CEOs before he started Nov. 1. And he regularly turned to Stavropoulos for guidance and support.



LAB GLOVES
Demand for Dow's chemicals and plastics is strong

HANDOVER

Last fall, Stavropoulos turned over the CEO job for the second time. The first time, his successor lasted two years

Inevitably, the business cycle will turn against Dow. To prepare, Liveris, 50, vows to hold capital spending below depreciation, with more of Dow's minimized budget going into low-cost sites outside the U.S. He doesn't see the need for more layoffs, after cutting 6,700 employees, or 13.5% of Dow's workforce, in the past two years. But Liveris says he'll be miserly about hiring during the upturn. Will it work? Stavropoulos hopes so. At age 65, he wants his retirement to last this time around. ■

—By Michael Arndt in Chicago

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THE BARKER PORTFOLIO BY ROBERT BARKER

TOPProspects

QUALITY RARELY COMES CHEAP. IF THAT DOESN'T startle you, hold on: No fewer than 7 in 10 of the BusinessWeek 50 stocks are trading within 10% of their 52-week highs. None is selling below 60%. From global energy titan Exxon Mobil to Rust Belt hero Cummins, the BusinessWeek 50 may make up today's elite among U.S. public companies. Yet as every stockpicker knows, great companies don't always make great stocks. Nor is every potentially great stock the right one for every portfolio.

With these cautionary guides in mind, I set out this year to select a handful of BusinessWeek 50 stocks that should prove suitable for you. Do you put a high premium on safety in your portfolio? Or maybe you can handle a bit of extra risk, so long as your downside isn't too steep? Perhaps you are aiming for the highest returns—and are willing to court the higher probability of rapid southbound volatility? For each level of risk, I've developed mini-portfolios for your consideration (tables, page 84).

For help in combing through the list in search of these stocks, I turned this year to Capital IQ, a division of Standard & Poor's (like *BusinessWeek*, a unit of The McGraw-Hill Companies). Capital IQ's online screening tools, which are used by financial professionals at more than 800 client firms, allowed me to evaluate the BusinessWeek 50 on scores of categories taking into account both company fundamentals and stock market trading data. For example, instead of simply measuring the list's current valuation ratios based on stock market values—that is, share price times shares outstanding—Capital IQ reckoned each company's total enterprise value, or stock market value plus total debt, net of cash and liquid investments.

Why bother? Checking enterprise values permits fairer comparisons among companies with vastly different capital structures. This puts companies with no debt and lots of cash—Apple Computer, for one—on the same footing as those, such as Nextel Communications, that rely on a load of borrowed money. Apple looks much more expensive than Nextel when gauged by simple market value-revenue ratios (3.5 times, vs. Nextel's 2.4 times). When seen through the wider-angle lens of enterprise values, however, Apple is actually cheaper (2.8 times revenue, vs. 2.9).

Next, once again using Capital IQ's data and computerized screening tools, I developed criteria for stocks worthy of investors with varying appetites for risk:

■ **For lower-risk portfolios.** If the broad stock market retreats, which of the 50 are more likely to resist the tide? Perhaps



TRUSTY TOOL Focusing on “enterprise value,” I assembled three portfolios of promising stocks for investors with different risk appetites

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those whose past ups and downs have had less to do with the market's general direction—or, in finance lingo, “low-beta” stocks. A beta of 1.0 indicates that a stock's movements match those of the Standard & Poor's 500-stock index; a stock with a beta of 0.5 has been half as volatile as the index; a beta of 2.0 twice as volatile. Stocks in our current ranking average a beta of 1.03. For lower-risk investors, I decided to look for stocks with betas of no more than 0.7. In addition, I wanted stocks with dividend yields of at least 2%, a tad more than the S&P 500's average yield and much more than the BusinessWeek 50's 0.8% yield. When companies run into trouble—a quarterly earnings disappointment, for example—a sturdy dividend lends a pillar of support.

These twin criteria proved sharp, eliminating all but three companies. Bank of America is tops in dividend yield, with a 4% payout. S&P sees earnings growing this year more than 9%. Along with its Oil Patch cousins, ChevronTexaco has been on a stock market tear. Yet it still trades at 10 times S&P's estimate of \$6.10 in 2005 earnings per share. Property-and-casualty insurer Chubb expects operating earnings to build on big 2004 gains, growing perhaps 7% or so to \$7.80 a share.

■ **For moderate-risk portfolios.** Here, I pursued a similar strategy but loosened the constraints a bit. Which companies have betas of more than 0.7, but less than 1.3? Which of those also offer dividend yields of at least 1%? Finally, to favor cheaper stocks, I accepted only those stocks trading at an enterprise value-revenue ratio of less than 3.6, the average multiple among the BusinessWeek 50.

With these criteria, five companies popped up, including Caterpillar. The big equipment maker, and exporter, is on a roll, with S&P estimating growth in earnings per share of 20% or more this year and next. Energy giant ConocoPhillips is trading at 11 times the \$10.34 a share that S&P expects it to earn this year. At Dow Chemical, cost-cutting is adding leverage to earnings growth; the stock is yielding 2.6%, to boot. Nike's new chief executive, William D. Perez, told Wall Street analysts in his maiden quarterly earnings conference call how he has been struck by the rich poten-

tial in the company's pipeline of new products. In fiscal 2005 beginning in June, Nike sees mid-teens growth in earnings per share. Truckmaker PACCAR enters its centennial year amid a cyclical upturn in its markets. S&P expects its earnings per share to jump 26%.

■ **For higher-risk portfolios.** With these selections, I wanted to tilt the odds toward action. So again I checked beta and set the computer screen to include only companies with betas of at least 1.3, or volatility 30% or more above the S&P 500's. At the same time, I aimed to increase the chances that future volatility would be upward, so I settled only on those stocks trading at least 15% off their 52-week highs.

These criteria produced a list of six familiar names, beginning with veteran design software maker Autodesk. It sees revenue growing about 12% this year. Cisco Systems, once the earth's most valuable company, now finds itself at No. 2 when ranked by market capitalization. It sees its fiscal 2005 sales growing 12% to 13% or so. Trading near \$36 a share, eBay has suffered a wicked fall since ending 2004 above \$59.

Yet it keeps producing a torrent of cash and sees earnings per share rising better than 20%. Mighty Microsoft also made the cut, with a share price that can't seem to get out of a rut. It even yields 1.3%—unusual downside protection for a tech stock. Soon to battle with Microsoft in security software, Symantec has seen its stock beaten down by its planned merger with Veritas Software. The riskiest of the bunch? Yahoo!, with a beta above 3. The company keeps reaching to take in more content created everywhere from Hollywood to the blogosphere.

One sure bet is that all of these stocks will not beat the market in the year ahead. If interest rates move sharply higher, BofA will be hurt, while much lower oil prices would punish ChevronTexaco and ConocoPhillips. Government investigations into insurers' complicity in helping companies manage their earnings could damage Chubb, which has been subpoenaed and is cooperating with the probes. Just the same, focusing on quality companies when building an investment portfolio is a step you're unlikely to regret. ■

PORTFOLIO PICKS From the BusinessWeek 50

LOWER RISK

COMPANY SYMBOL	PRICE	DIVIDEND YIELD	BETA
Bank of America (BAC)	\$44.80	4.0%	0.7
ChevronTexaco (CVX)	58.61	2.7	0.6
Chubb (CB)	78.86	2.2	0.7

MODERATE RISK

COMPANY SYMBOL	PRICE	ENTERPRISE VALUE/ REVENUE RATIO	DIVIDEND YIELD	BETA
Caterpillar (CAT)	\$96.27	1.9	1.7%	1.1
ConocoPhillips (COP)	106.51	0.7	1.9	0.8
Dow Chemical (DOW)	51.64	1.5	2.6	0.9
Nike (NKE)	86.44	1.7	1.2	0.8
PACCAR (PCAR)	73.90	1.4	1.1	1.1

HIGHER RISK

COMPANY SYMBOL	PRICE	BETA	PRICE AS % OF 52 WEEK HIGH
Autodesk (ADSK)	\$29.19	1.3	75%
Cisco Systems (CSCO)	18.07	2.2	73
eBay (EBAY)	36.48	2.1	62
Microsoft (MSFT)	24.63	1.5	82
Symantec (SYMC)	20.53	1.6	60
Yahoo! (YHOO)	31.58	3.1	79

Data as of Mar 16

Data: Capital IQ



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Charlton Monsanto
Senior Vice President and CIO
Prudential Fox & Roach REALTORS



access

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The Ranking

From oil companies feasting on high prices to one of the oldest surviving software companies, here is the Class of 2005

NUCOR CORP.

» **WHEN THE U.S.** steel industry was in a downward spiral four years ago, Nucor was ready. The industry's lowest-cost producer embarked on an aggressive buying spree, shelling out more than \$1.1 billion to acquire 10 steel plants from troubled sellers, snapping up assets at an average of 17¢ on the dollar. Last year, steel was booming again, and Nucor, based in Charlotte, N.C., was in position to reap the rewards. A combination of massive steel-plant closures coupled with the Chinese manufacturing boom caused steel prices to soar from the \$200-to-\$300-a-ton range common in the late 1990s to as much as \$700 in 2004. Nucor's profits soared from \$62.8 million in 2003 to \$1.1 billion in 2004, and it delivered a sector-leading 32.5% return on equity. Shareholders made out well, too: The company's stock has returned 100.5% in the 12 months that ended on Feb. 28.

INDUSTRY
Materials
SALES
\$11.4 billion
NET INCOME
\$1.1 billion



DANIEL R. DiMICCO, 54
CEO since 2000

50



JAMES J. MULVA, 58
CEO since 2002



DAVID O'REILLY, 58
CEO since 2000



WILLIAM E. GREEHEY, 68
CEO since 1980



WILLIAM W. MCGUIRE, 56
CEO since 1991

CONOCO PHILLIPS

INDUSTRY

Energy

SALES

\$118.7 billion

NET INCOME

\$8.1 billion

CHEVRON TEXACO CORP.

INDUSTRY

Energy

SALES

\$142.9 billion

NET INCOME

\$13 billion

VALERO ENERGY CORP.

INDUSTRY

Energy

SALES

\$54.6 billion

NET INCOME

\$1.8 billion

UNITEDHEALTH GROUP INC.

INDUSTRY

Health-Care

Equipment & Services

SALES

\$37.2 billion

NET INCOME

\$2.6 billion



RAY R. IRANI, 70
EO since 1990

2

» **NEARLY THREE** years after the merger that created it, ConocoPhillips is proving a nimble competitor. It's built an enviable portfolio of oil and gas projects, including a 10% stake in Russia's Lukoil. Properties like that should keep production growing at a healthy clip. The Houston-based company is also investing in refining projects that let it benefit from lower prices for heavier, lower-quality oils. Surging energy prices played a part in last year's rich profits, which rose 77%. But aggressive cost-cutting and asset sales gave it financial might to pursue big plans abroad.

3

» **THE NATION'S** second-largest oil producer has never been more profitable. Net income in the past year leaped 77%. Harder to come by was growth in oil and gas production, which dipped 4.8%, to 2.5 million barrels per day, due to damage from Hurricane Ivan, normal production declines in some fields, and sales of less profitable wells. The San Ramon (Calif.) company is trying to build facilities to import liquefied natural gas in several locations, and will boost overall capital expenditures 18% this year, to \$10 billion. But O'Reilly also may choose to expand via a major acquisition.

4

» **STRONG DEMAND** and high margins pushed San Antonio independent refiner Valero Energy's profits up 190% last year. Valero's costs are lower because it is set up to handle so-called heavy and sour crudes, lower-quality grades of oil that enjoy a big discount to the benchmark West Texas Intermediate. Margins are likely to stay strong, as growth in refining capacity lags behind demand for gasoline, jet fuel, and other refined products. No wonder Valero is investing in new capacity in such places as Louisiana, Texas, and Aruba, and is also on the prowl for refinery acquisitions.

5

» **THROUGH** employers, associations such as AARP, and state governments, UnitedHealth now counts a staggering 55 million Americans among its customers. A serial acquirer in a fast-consolidating industry, the diversified health-care management firm added the Oxford Health Plans in the New York area in 2004. Such deals help drive rich gains, such as 2004's 42% rise in net earnings. To keep the gains coming, the Minnetonka (Minn.) outfit is moving into serving state Medicaid programs and health-related transaction processing.

OCCIDENTAL PETROLEUM CORP.

» **IN A PAGE** taken from the playbook of his globe-trotting predecessor, Armand Hammer, Irani paid a personal call to the desert retreat of Libyan dictator Muammar Gaddafi last year. In January, Los Angeles-based Occidental, which discovered huge oil fields in Libya in the 1960s, emerged as the top bidder for new concessions there—19 years after sanctions against the country were first imposed. Irani, who was born in Lebanon, has been prospecting elsewhere in the Middle East, including Qatar and Oman. But even without those new fields, Oxy has been among the fastest-growing oil producers. Irani placed a big bet a few years ago by buying aging oil fields in California and Texas, then using techniques such as injecting carbon dioxide or water to pump more out of the wells. Worldwide production rose 3.5% last year, and earnings shot up 63%. Few squeeze as much out of a barrel of oil as Oxy does: Its net margin was 22.9% last year, vs. 17.3% in 2003.

INDUSTRY

Energy

SALES

\$11.4 billion

NET INCOME

\$2.6 billion

6

50

LEE R. RAYMOND, 66
CEO since 1993



EXXON MOBIL CORP.

» **EXXONMOBIL RELISHES** its role as the "boring" oil giant. That means producing consistent, industry-leading results, like last year's 24% return on capital employed. Sure, high oil and gas prices and strong refining and chemical margins lifted all boats in this industry. But the Irving (Tex.) company's worldwide scope, investing discipline, and leading technology keep it on top in oil booms and busts alike. It's spending heavily to find and produce oil and gas in places like Qatar and Russia. With more than \$43 billion in cash from operations and asset sales last year, though, Exxon had plenty left over for shareholders. Its shares have returned 53.4% in the year ended Feb. 28, helped by \$15 billion in 2004 in dividends and share repurchases. Exxon also built on strengths in chemicals and refining, as other rivals pulled back. And the company boosted its bottom line with unrelenting efforts to drive down costs, including better refinery reliability, improved energy efficiency, and job cuts. It has targeted another \$1 billion in efficiencies in 2005.

INDUSTRY
Energy
SALES
\$270.8 billion
NET INCOME
\$25.3 billion

7



TERRY SEMEL, 62
CEO since 2001

YAHOO! INC.

INDUSTRY
Software & Services
SALES
\$3.6 billion
NET INCOME
\$839.6 million

8

» **THE BOOMING** Internet search market has fueled growth at Yahoo!, owner of the most popular search engine after Google. But unlike its upstart competitor, Sunnyvale (Calif.)-based Yahoo runs several other thriving businesses. These include subscription services, such as online personals and fantasy sports leagues, as well as multimedia branded ads. That balanced approach paid off in 2004 sales that more than doubled, while net profits surged by 253%. Yahoo's stock has returned 45.6% through Feb. 28—and 346.3% over the past three years.



TIMOTHY M. DONAHUE, 56
CEO since 1999

NEXTEL COMMUNICATIONS INC.

INDUSTRY
Telecommunication Services
SALES
\$13.4 billion
NET INCOME
\$3 billion

9

» **BY STICKING TO** its quirky niche, Nextel Communications Inc. rose above the cutthroat pricing that plagued other wireless calling outfits. The Reston (Va.) company serves less price-sensitive business customers with a unique walkie-talkie-like service called Direct Connect. With this loyal and lucrative customer base, Nextel boasts the highest revenue per subscriber in the industry—\$68 a month—and one of the lowest churn rates—1.5%. Profits almost doubled last year. Nextel's pending merger with Sprint Corp. promises to give customers an even broader suite of services.



G. STEVEN FARRIS, 57
CEO since 2002

APACHE CORP.

INDUSTRY
Energy
SALES
\$5.3 billion
NET INCOME
\$1.7 billion

10

» **WHEN APACHE GOT** its start in 1954, the thrill of the oil business lay in drilling new exploratory wells. Now oilmen realize it's much safer to "acquire and exploit" existing fields, and few do that better than Houston-based Apache. The company hiked production at the Forties Field in the North Sea by 50% after acquiring it from BP PLC, all the while cutting costs by automating production and switching from diesel generators to natural gas produced on-site. Earnings jumped 52% last year, giving Apache a staggering 31.5% net margin. Expect more canny deals this year.



J. LARRY NICHOLS, 62
CEO since 1980

DEVON ENERGY CORP.

INDUSTRY
Energy
SALES
\$9.2 billion
NET INCOME
\$2.2 billion

11

» **DEVON IS** swimming in cash. Thanks to a 10% increase in production and rising oil and gas prices, profits jumped 26% last year. It's spending heavily to drill in areas such as the Barnett Shale in north Texas, the Gulf of Mexico, and offshore Brazil. But Devon also is hiking dividends and buying back shares—reflected in its 65.8% stock return in the past year. Criticized in the past for its spending to find new deposits, the Oklahoma City company now wins praise for the savings it has wrung from a string of acquisitions. No wonder some consider it a takeover target.

RICHARD J. DUGAS JR., 39
CEO since 2003

12

PULTE HOMES INC.

» **ROCK-BOTTOM INTEREST** rates and a steady supply of aging baby boomers for its "active adult" homes kept Pulte growing in 2004. Geographic diversification across the U.S. shielded the Bloomfield Hills (Mich.) builder from some regional fluctuations. Profits last year jumped 61%, as strong demand in the Southeast offset weakness in some Western markets. Pulte's new orders in the Southeast, for instance, shot up 45% in the fourth quarter. But the red-hot Las Vegas market suddenly cooled, forcing the company to slash prices there. Pulte also spreads its bets demographically, catering to first-time buyers and move-ups, as well as getting one-third of sales from new retirees. Rising interest rates remain a risk to sales growth. To cut costs, Pulte is experimenting with computerized methods of factory pre-assembly. After selling its Argentine unit in January, analysts expect the builder to soon divest its units in Puerto Rico and Mexico.

INDUSTRY
Consumer Durables & Apparel
SALES
\$11.7 billion
NET INCOME
\$998 million

IRWIN M. JACOBS, 71
CEO since 1985

QUALCOMM INC.

INDUSTRY
Technology Hardware & Equipment
SALES
\$5.1 billion
NET INCOME
\$1.8 billion

13

» **WHEN QUALCOMM** announced on Mar. 8 that legendary founder and CEO Irwin Jacobs will retire in July, investors pushed the stock down 4%, to \$36. Their nervousness was understandable: Jacobs almost single-handedly developed a popular cell-phone standard called CDMA. San Diego-based Qualcomm takes a piece of every CDMA phone sold and supplies most of their chips. Profits have jumped an average annual 91.8% over three years; net margins are 36.1%. Now it's up to Jacobs' son and successor, Paul, to ensure the continued growth of advanced cell-phone technologies.

STEVEN P. JOBS, 50
CEO since 1997

APPLE COMPUTER INC.

INDUSTRY
Technology Hardware & Equipment
SALES
\$9.8 billion
NET INCOME
\$508 million

14

» **THERE'S NO LONGER** any doubt that Steve Jobs has completed Apple's return to glory. Thanks to runaway sales of the iPod music player, Apple increased its already dominant share of the fast-growing digital music business in 2004. Earnings nearly quadrupled, and Apple's stock soared 275.1% through Feb. 28. Market share is expected to rise for the Mac computer as well, particularly if Apple expands distribution to hawk products such as its low-cost Mac mini. Investors are clearly betting that Cupertino (Calif.)-based Apple is positioned to put its stamp on many new digital markets.

KEVIN B. ROLLINS, 52
CEO since 2004

DELL INC.

INDUSTRY
Technology Hardware & Equipment
SALES
\$49.2 billion
NET INCOME
\$3 billion

15

» **DELL CONTINUES** to mint money where others fear to tread: the cutthroat personal-computer market. Almost 80% of Dell's revenue last year came from desktops and notebooks, but that didn't stop the Round Rock (Tex.) giant from increasing sales by 19% and profits by 15%. Dell is expanding even faster overseas, and its nascent printer line topped \$1 billion in sales in 2004. Little wonder Dell is gunning for \$80 billion in annual revenue in the next several years. That would put it on par, size-wise, with archrival Hewlett-Packard Co. and within striking distance of IBM.

MARK C. PIGOTT, 51
CEO since 1997

PACCAR INC.

INDUSTRY
Capital Goods
SALES
\$11.4 billion
NET INCOME
\$906.8 million

16

» **PACCAR IS KNOWN** for its long-haul Peterbilt and Kenworth trucks—and its ability to make money for investors. The Bellevue (Wash.) company ranks in the top 5% of the Standard & Poor's 500 for three-year return to shareholders through Feb. 28, at 159%. An upsurge in big-irg orders certainly put PACCAR into overdrive, boosting sales and net income to record highs. But PACCAR moved its market share to an all-time high thanks to the reputation of its custom-built trucks. And with the biggest order backlog ever headed into 2005, this long ride seems far from over.



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50



JOHN G. DROSDICK, 61
CEO since 2000

MARGARET C. WHITMAN, 49
CEO since 1998

BOBBY SHACKOULS, 54
CEO since 1995

GLENN M. RENWICK, 49
CEO since 2001

SUNOCO INC.

INDUSTRY
Energy
SALES
\$23.2 billion
NET INCOME
\$615 million

EBAY INC.

INDUSTRY
Retailing
SALES
\$3.3 billion
NET INCOME
\$778.2 million

BURLINGTON RESOURCES INC.

INDUSTRY
Energy
SALES
\$5.6 billion
NET INCOME
\$1.5 billion

PROGRESSIVE CORP.

INDUSTRY
Insurance
SALES
\$13.8 billion
NET INCOME
\$1.6 billion



LEW FRANKFORT, 59
CEO since 1995

17

18

19

20

21

COACH INC.

» **FEW FASHION BRANDS** have caught the updraft in luxury-goods spending as well as handbag maker Coach. Its 2004 profits soared 63%, on a 36% increase in sales. Shareholders were rewarded with a 40.1% return on the stock through Feb. 28. CEO Frankfort has carefully positioned New York-based Coach at the entry level of luxury, with average prices nearly half those of rivals like Louis Vuitton, Hermès, and Gucci. At same time, design head Reed Krakoff, 41, has expanded the brand's appeal by adding more fashionable and colorful bags and accessories. This has taken the brand far beyond the utilitarian purses it was once known for. Loyal customers are now shopping more frequently to buy bags for different occasions. Frankfort has elevated the brand further by concentrating growth in its own stores where it has complete control of its image, while cutting dependence on department stores. With more fashion comes more risk, but so far Coach has hit the mark.

INDUSTRY
Consumer Durables & Apparel
SALES
\$1.5 billion
NET INCOME
\$325.8 million

» **SUNOCO IS WELL-** positioned to profit from the high margins that refineries are tapping in the current cycle. Philadelphia-based Sunoco increased capacity last year, buying a 150,000 barrel-per-day refinery as well as 385 filling stations to sell its gasoline. And while some other refiners unloaded chemical operations that had turned stagnant, Sunoco stood pat. It rode out the drought and now stands to profit from a cyclical recovery. Profits have nearly doubled in the past 12 months. The company also reduced debt and interest expense by replacing high-rate debt with new, lower-rate bonds.

» **AFTER YEARS** of outrunning expectations, the online marketplace is slowing down. As eBay merchants increasingly diversify, selling on other online venues such as Amazon.com and Google, sales growth is expected to ease to 31% this year, from 51% over the past 12 months. Profits, already under pressure from rising online ad rates, will be further squeezed by plans to spend more on expansion in China and on eBay's PayPal payment processing unit. Still, with 81% gross margins, the San Jose (Calif.) company remains the envy of e-commerce rivals.

» **HOUSTON-BASED** Burlington could very well be sitting on black gold. One of the biggest independent exploration and production companies, Burlington has a large enough inventory of oil and gas to keep it busy drilling for the next five years. And that's after a year in which sales surged 30% and the company threw off \$3.4 billion in operating cash. Unlike competitors that spent heavily on acquisitions as high prices sent profits soaring, Burlington is looking for organic growth, investing \$2 billion to expand drilling this year, up from \$1.7 billion in 2004.

» **AUTO INSURERS** had a smooth ride last year, thanks in part to rising rates and fewer accident claims. But with its low-cost advantage and high-touch service, Progressive zoomed ahead—fattening underwriting margins from 12.7% to 14.9% and boosting net income by 31%. Revenue growth at the Mayfield Village (Ohio) company is likely to slow this year as cash-flush competitors chase new business and drive down prices. But with innovations such as Progressive's "concierge" service, which handles nearly every aspect of a customer's car repairs, the potholes should be minor.

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SLIM SCREEN



INTEGRATED PORTS



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50

**EDWIN M.
"MAC"
CRAWFORD,**
55, CEO
since 1998



22

CAREMARK RX INC.

» **MILLIONS OF AMERICANS** ordering up their next bottle of meds helped pharmacy benefits manager Caremark surge mightily last year. The \$6 billion acquisition in March of competitor AdvancePCS allowed Caremark to play both sides of the prescription-filling business: Mail-order claims rose 73%, while retail claims soared a staggering 253%. Strong growth in sales both of specialty drugs and of the highly profitable generics pushed total net income up 106%. A potential federal investigation into alleged Medicaid fraud could prove to be a problem. Justice Dept. officials indicated last month that they will seek control of a multistate inquiry into Medicaid payments for prescription drugs, which the government contends should have been covered by the company, not Medicaid, because the purchasers had Caremark benefits. Still, with the \$1.1 billion in cash it has on hand, Nashville-based Caremark is expected to buy more small benefits managers in the fragmented industry.

INDUSTRY
Health-Care
Equipment &
Services
SALES
\$25.8 billion
NET INCOME
\$600.3 million



**JAMES W.
OWENS,** 59
CEO since 2004

CATERPILLAR INC.

INDUSTRY
Capital Goods
SALES
\$30.3 billion
NET INCOME
\$2 billion

23

» **THE WORLD'S** hunger for raw materials has paid off hugely for Caterpillar. Orders for its earth-moving equipment and heavy-duty engines poured in faster than Cat could build them, especially in the U.S. After years of struggling with minimal price hikes, the Peoria-based manufacturer finally gained leverage with its customers. It was able to raise prices three times in a year. The result: an 85% jump in profits, to an all-time high, with revenue topping \$30 billion for the first time. Shares have returned 28% over the past 12 months. And Cat's not done: Prices are going up 1% to 5% more in late spring.



**J. STEVEN
WHISLER,** 50
CEO since 2000

PHELPS DODGE CORP.

INDUSTRY
Materials
SALES
\$7.1 billion
NET INCOME
\$1.0 billion

24

» **COPPER PRICES** are on a roll, and so is Phoenix-based Phelps Dodge. Strong demand, particularly from construction markets in China, have helped double copper prices in the past two years, to \$1.50 a pound. In 2004 the world's largest publicly traded copper producer increased earnings nearly sixtyfold. Next, Phelps Dodge expects to begin an \$850 million expansion at its mine in Peru that will triple production, to 300,000 tons per year, by 2007. Phelps Dodge also hopes to finalize federal approvals for a mining site in Safford, Ariz.—the first new U.S. copper mine in 30 years.



**CAROL A.
BARTZ,** 56
CEO since 1992

AUTODESK INC.

INDUSTRY
Software & Services
SALES
\$1.2 billion
NET INCOME
\$221.5 million

25

» **A REBOUND IN** technology spending, a slew of innovative design tools, and smart investments in hot overseas markets have helped this 23-year-old software maker post 30% sales growth over the past year. Modest layoffs and other cost-cutting contributed to an 84% boom in profits. And shareholder returns more than doubled through Feb. 28. Thanks to continued product innovation and the rise of global manufacturing networks, Autodesk is poised to post strong double-digit sales and profit growth in 2005. The San Rafael (Calif.) company remains the king of the hill for engineering tools.



**WILLIAM C.
WELDON,** 56
CEO since 2002

JOHNSON & JOHNSON

INDUSTRY
Pharmaceuticals &
Biotechnology
SALES
\$47.3 billion
NET INCOME
\$8.5 billion

26

» **IN A YEAR WHEN** its drug company rivals were stumbling, Johnson & Johnson continued to prosper. Its broad portfolio of businesses offset weakness in one market with strength in other lines. So while J&J's franchise in drug-coated cardiac stents and its blockbuster anemia drug Procrit lost steam to new competition, other prescription drugs and medical devices helped fuel an 18% increase in net income. The New Brunswick (N.J.) company's deep pockets came in handy: In late 2004, J&J struck a \$24 billion deal to acquire cardiac-device maker Guidant Corp.

AC and... interests... Motors... 2005 G... reserve



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Viruses are always lurking. That's why you need a better way to protect your computer. And that's why America Online® now gives away comprehensive computer virus protection to our members absolutely free.

While you might assume your computer has virus protection built in, that's not always true.

America Online version 9.0 helps protect your whole computer, not just e-mail.* And it checks for updates to protect against new known viruses. It even scans for spyware every time you log on to AOL®

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want a better internet? you belong at America Online.

**America
Online®**



**BROADBAND
WIRELESS
DIAL-UP**

Must be 18 or older and a U.S. resident to register for AOL. A major billing method is required. Anti-virus protection available to members using AOL 9.0 software on Windows operating systems. *A separate download and/or activation may be required. See AOL Keyword: Anti-virus for details. Use of AOL features on broadband or wireless connections may require purchase of additional equipment and third party services. America Online and AOL are registered trademarks of America Online, Inc. The triangle design is a trademark of America Online, Inc. © 2005 America Online, Inc. All rights reserved.

50



BRUCE R. CHIZEN, 49
CEO since 2000

THEODORE M. SOLSO, 58
CEO since 2000

JAMES R. TOBIN, 60
CEO since 1999

MARK G. PAPA, 58
CEO since 1998

ADOBE SYSTEMS INC.

INDUSTRY
Software & Services
SALES
\$1.7 billion
NET INCOME
\$450.4 million

CUMMINS INC.

INDUSTRY
Capital Goods
SALES
\$8.4 billion
NET INCOME
\$350 million

BOSTON SCIENTIFIC CORP.

INDUSTRY
Health Care
Equipment & Services
SALES
\$5.6 billion
NET INCOME
\$1.1 billion

EOG RESOURCES INC.

INDUSTRY
Energy
SALES
\$2.3 billion
NET INCOME
\$624.9 million



27

CARNIVAL CORP.

» **CRUISE QUEEN CARNIVAL** last year put to rest the dark memories of September 11 and its profit-crushing aftermath. Buoyed by rising ticket prices and fatter passenger spending, the Miami cruise line saw net income surge 55%. Net revenue yield, the amount of profit that Carnival receives from each passenger per day, rose 9.8%. Those advances were driven largely by a sharp increase in cash ponied up by passengers for food, drinks, entertainment, and other onboard frills. Outlays on tickets jumped 48%, to \$7.4 billion, while nonticket revenue soared 50%, to \$2.1 billion. An unusually harsh hurricane season, with a record four storms hitting Florida, put a damper on Atlantic and Caribbean cruises late in the year. But the company, anticipating a quick recovery, spent lavishly. Carnival launched eight cruise ships, including the Queen Mary 2, and ordered six more. With advance bookings for this year running ahead of 2004, Carnival is sailing smoothly for now.

INDUSTRY
Hotels,
Restaurants &
Leisure
SALES
\$9.7 billion
NET INCOME
\$1.9 billion

28

» **LAST YEAR WAS** the best of all possible worlds for Adobe. Its core markets—advertising, publishing, and other creative industries—returned to relative stability. It was the first full year that the San Jose (Calif.) company sold its Creative Suite, bundling popular products such as Photoshop and InDesign. As digital cameras proliferate, so have sales of Photoshop for regular folks. Adobe also is starting to get a piece of the document security market by emphasizing tamperproof features on its Acrobat Reader software. Add it up, and Adobe's bottom line rose by 69%.

29

» **WITH BUSINESS** booming, the nation's trucking outfits are finally trading in their old rigs for new ones. And that means good times are here again for Cummins. The diesel-engine maker boosted its earnings by 548% last year. The driver for that growth was greater demand for highway trucks in the U.S., which ended a three-year slump. Cummins also did well in China, where sales doubled in its joint-venture with Dongfeng Automotive Corp. The Columbus (Ind.) company expects another record-breaking year in 2005, although Solso concedes Cummins won't match its 2004 growth rates.

30

» **BOSTON SCIENTIFIC** got a lot of bad press last summer when it was forced to recall about 100,000 of its revolutionary new Taxus drug-coated coronary stents. But the trouble proved to be temporary as stent sales soared 345%, to \$2.4 billion, helping earnings more than double. The reason: Most doctors believe Taxus cuts the odds that coronary arteries will relog after angioplasty. But with the stock down from its peak over concerns about stent competition, the Natick (Mass.) company is spending heavily to expand into promising new businesses, such as spinal cord stimulation, which is used to help manage pain.

31

» **WHO SAYS** nothing good came from Enron? EOG, spun off from the disgraced energy giant in 1989 as Enron Oil & Gas, is riding tall in the saddle thanks to surging energy prices. In 2004 the Houston-based producer increased sales by 30% and recorded a 43% rise in profits. With supplies still tight, especially in its core North American natural gas market, EOG is boosting production 13.5% in 2005, up from a 10% gain last year. It recently paid \$320 million to bolster its capacity in Canada and is exploring for more in Texas, Trinidad, and the North Sea. Now that's stepping on the gas.

50



JAMES L. DONALD,
51, CEO since
March, 2005



LARRY F. PROBST III, 54
CEO since 1994



LARRY C. GLASSCOCK, 56
CEO since 1999



ROBERT W. LANE, 55
CEO since 2000



JOHN W. THOMPSON
55
CEO since
1999

STARBUCKS CORP.

INDUSTRY
Hotels, Restaurants & Leisure
SALES
\$5.6 billion
NET INCOME
\$424.8 million

ELECTRONIC ARTS INC.

INDUSTRY
Software & Services
SALES
\$3.2 billion
NET INCOME
\$586.6 million

WELLPOINT INC.

INDUSTRY
Health-Care Equipment & Services
SALES
\$20.8 billion
NET INCOME
\$960.1 million

DEERE & CO.

INDUSTRY
Capital Goods
SALES
\$20.6 billion
NET INCOME
\$1.5 billion

32

SYMANTEC CORP.

» **IN HIS SIX-YEAR TENURE**, CEO Thompson has turned a stalling, \$600 million software company into a \$2 billion security powerhouse—and the markets have thanked him. Symantec's stock has appreciated 1,000% since he took the helm in 1999. Last year profits at the Cupertino (Calif.) company jumped 66%—and that was just below the average annual pace for the past three years. Still, Thompson has his work cut out integrating a planned \$13 billion merger with storage-software maker Veritas Software Corp. Wall Street doesn't like the deal—the stock has sold off more than 30% since it was announced late last year. Some investors are starting to see the connection between securing and backing up companies' information, but there are concerns about growth. Right now, anti-virus software alone could keep Symantec growing at 18%-20% a year, analysts say. Thompson estimates similar growth for the first year of the combined company, but integrating the largest software merger ever attempted will be tricky.

INDUSTRY
Software & Services
SALES
\$2.4 billion
NET INCOME
\$533.4 million

33

» **THE SEATTLE** company got a lot of mileage out of the multiplatinum Ray Charles CD *Genius Loves Company*, which it helped market and produce. That signaled a broad music initiative that gets Starbucks into everything from downloads at in-store media bars to the production and distribution of new music. But Starbucks still makes most of its money selling caffeine to the masses. Net income soared 42% in the past 12 months. Future profit growth could be hurt by rising costs of coffee and wages. Still, new CEO Donald plans 1,500 store openings in fiscal 2005.

34

» **THE WORLD'S** largest independent video-game publisher went on the offensive in 2004. After facing its toughest competition in years in its core sports-games business, the Redwood City (Calif.) company paid \$800 million for exclusive rights to make games using players and team logos from the National Football League. The creator of the lucrative *Madden Football*, James Bond, and Harry Potter game franchises also purchased a big stake in French publisher Ubisoft. But its stock was sent tumbling after the Mar. 21 news that fiscal year earnings would miss projections because of rising competition.

35

» **BY PULLING** together Blue Cross or Blue Shield health networks from 13 states, WellPoint has fashioned itself into the country's biggest health insurer, serving nearly 28 million members. It sprang from the merger in November, 2004, of two regional powerhouses, California's WellPoint Health Networks and Anthem, based in Indianapolis. The \$16.5 billion deal faced some costly delays as WellPoint had to agree to spend millions to expand health care for the poor and uninsured. Still, the combined company posted 24% gains in both earnings and sales last year.

36

» **AFTER A DOWN-**turn that stretches back to the 1990s, the U.S. agriculture sector is back—and so is Deere. With farm incomes at record highs in 2004, Deere's earnings nearly doubled from the 2003 bottom line. Its three-year average annual growth was 85.2%, easily placing Deere in the top 10% of S&P 500 companies by that measure. The Moline (Ill.) company owes its record year to more than farmers. Sales of heavy equipment for construction and forestry soared by more than 50%. Deere is not expecting a repeat in 2005, however, as its markets cool.



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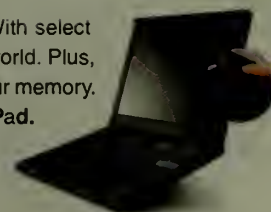
Your birthday. Your kid's name. Your college. Your mother's maiden name. Your other kid's name. The first word you ever said.
 Your favorite Christopher Marlowe quote. Your golf handicap followed by the weight of your sister's baby. Your father's cat.
 A combination of upper and lower case letters with at least three numerals. The first fish you ever caught.
 Your SAT score combined with the word "hat". The name of the dog you would have given yourself. Your dog's name.
 The name on your vanity plate. Mississippi. Or is it Mississippi? Your former dog's name. MacGyver.
 The name of the dog who lived upstairs when you were five. Your chewing gum of choice.
 The 20th president. Your GPS location.

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IMPOSSIBLE TO FORGET

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ibm.com/think



50



J. RAYMOND ELLIOTT, 55
CEO Since 2001

FREDERICK W. SMITH, 60
CEO since 1971

JOHN D. FINNEGAN, 58
CEO since 2001

ZIMMER HOLDINGS INC.

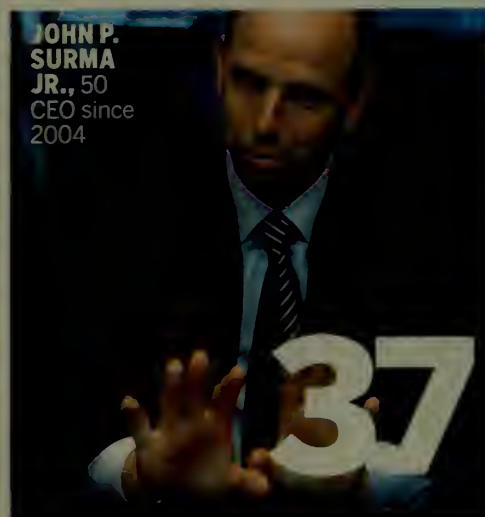
INDUSTRY
Health-Care
Equipment & Services
SALES
\$3 billion
NET INCOME
\$541.8 million

FEDEX CORP.

INDUSTRY
Transportation
SALES
\$27.4 billion
NET INCOME
\$1.3 billion

CHUBB CO

INDUSTRY
Insurance
SALES
\$13 billion
NET INCOME
\$1.5 billion



JOHN P. SURMA JR., 50
CEO since 2004

U.S. STEEL CORP.

» **A CENTURY AFTER** it came to epitomize Big Steel, Pittsburgh's U.S. Steel is back. Thanks largely to China's enormous appetite for steel, which boosted prices around the globe, U.S. Steel swung from a loss in 2003 to a \$1.1 billion profit last year. U.S. Steel didn't just reap the benefits of the economic cycle—it also helped itself by picking up bankrupt National Steel and crafting a cost-cutting labor deal with steelworkers. The new contract not only eliminated jobs but erased retiree obligations at its acquired mills. U.S. Steel also boosted its low-cost operations in Central Europe. After doubling in 2004, prices for U.S. Steel's high-end products have now leveled off. But orders are keeping its mills running flat out. And with \$1 billion in cash, U.S. Steel is shopping for more overseas assets, notably in China. U.S. Steel's stronger numbers may not be enough to keep it independent, however. Some analysts say the company could get acquired by even larger foreign steelmakers eager for a U.S. base.

INDUSTRY
Materials
SALES
\$14 billion
NET INCOME
\$1.1 billion

38

» **JUST TWO YEARS** ago, Zimmer Holdings ranked 26th in *BusinessWeek's* list of hottest small companies. Today, the artificial-joint maker has outgrown that contest, but Zimmer is still hot. Sales and earnings have both climbed at an average annual pace of more than 35% for three years running. Zimmer specializes in making prosthetic knees and hips designed for minimally invasive surgery, which is rapidly gaining acceptance. And the Warsaw (Ind.) company moved into spinal reconstruction through its 2003 takeover of Switzerland's Centerpulse.

39

» **AS THE DIGITAL** revolution took hold in the late 1990s, Memphis-based FedEx didn't sit by and wait for its overnight delivery business to be eroded by e-mail and other new technologies. It went on the offensive, snapping up major trucking outfits and extending its "just in time" service into heavier freight and package delivery. Last year, FedEx acquired the Kinko's chain to position itself as the shipping and printing service of choice for home-based entrepreneurs. So even as its overnight document business has slipped, FedEx' diversification paid off in spades: Profits doubled in 2004.

40

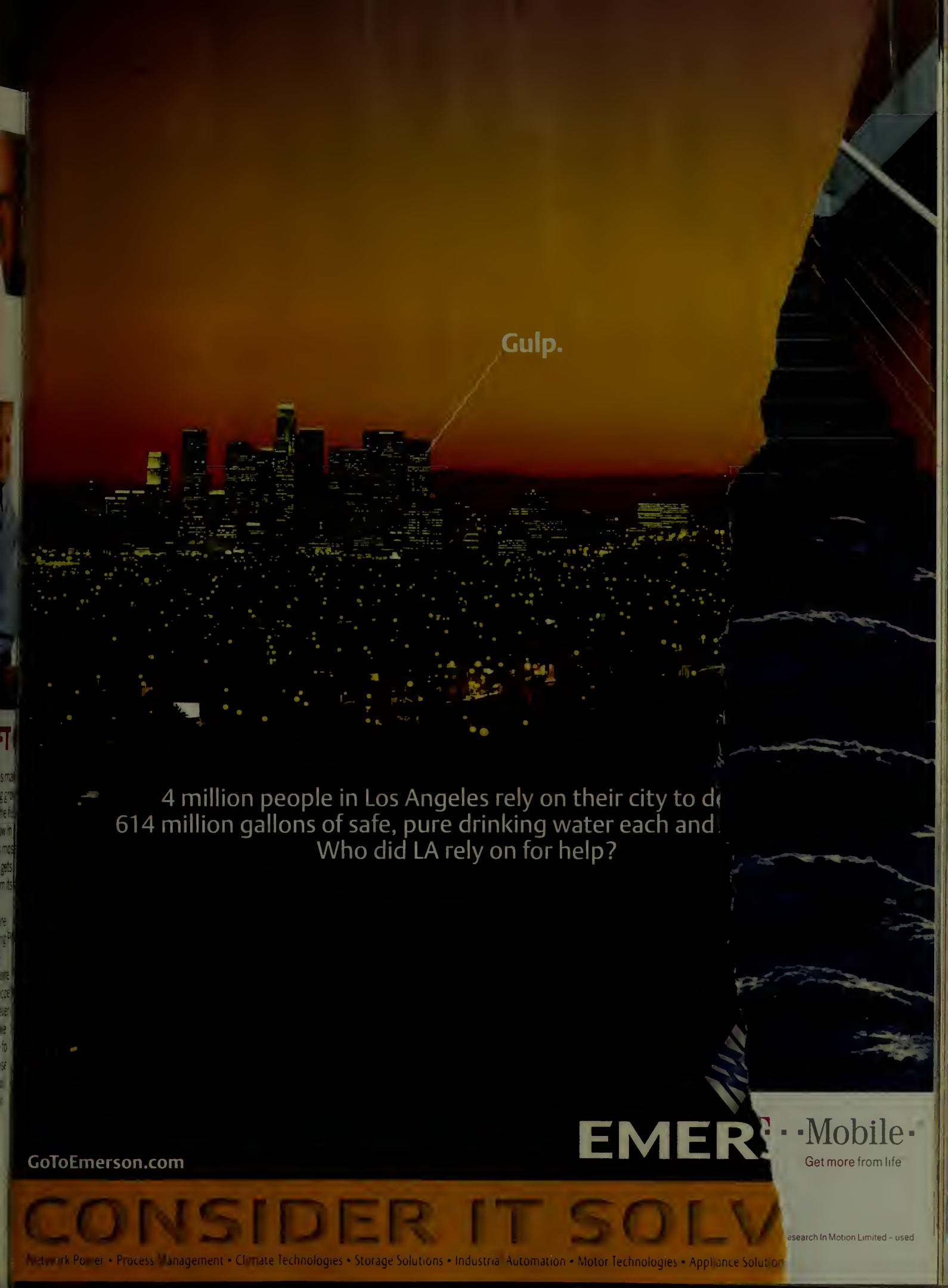
» **CHUBB MAKE** rich living by insuring niche clients, from homes and cars to wealthy to spec businesses doing everything from making medical devices to digging mines. Its near-doubling of earnings last year was skewed by a big year-end write-off. Still, C. Warren Finnegan works to keep Warren-based Chubb in the top tier. He shed problem units, like one that insured institutional portfolios against loss. And tightened contracts and sharpened underwriting. The one reason Chubb was a rare insurer scoring double-digit stock returns in the past 12 months.



STEVEN A. BALLMER, 49
CEO since 2000

MICROSOFT

» **SURE, MICROSOFT** is making a match the eye-popping growth of youth. Its revenue for the first six months of 2005 is expected to grow in the single digits. That's mostly because Microsoft still gets a lion's share of sales from its Windows and Office monopolies, and they are dependent on the cooling PC business. Moreover, the Redmond (Wash.) software giant has had limited success finding fresh fountains of revenue by expanding into new markets, from video games to software for businesses. For all of those Microsoft still manages to grow. The company pursued the most recent 12-month monopolies that are kicking money. Ballmer has resqueezed costs, from elder business travel. New growth compensation, replacing grants, also pared costs.



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614 million gallons of safe, pure drinking water each and every day.
Who did LA rely on for help?

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EMERSON • Mobile •
Get more from Life

CONSIDER IT SOLVED

research In Motion Limited – used

Network Power • Process Management • Climate Technologies • Storage Solutions • Industrial Automation • Motor Technologies • Appliance Solutions

THE BUSINESSWEEK 50



J. RAYMOND ELLIOTT, 55
CEO Since 2001

ZIMMER HOLDINGS INC.

INDUSTRY
Health-Care
Equipment & Services
SALES
\$3 billion
NET INCOME
\$541.8 million



FREDERICK W. SMITH, 60
CEO since 1971

FEDEX CORP.

INDUSTRY
Transportation
SALES
\$27.4 billion
NET INCOME
\$1.3 billion



JOHN D. FINNEGAN, 56
CEO since 2002

CHUBB CORP.

INDUSTRY
Insurance
SALES
\$13 billion
NET INCOME
\$1.5 billion



BOB R. SIMPSON, 56
CEO since 1993

XTO ENERGY INC.

INDUSTRY
Energy
SALES
\$2 billion
NET INCOME
\$507.9 million



JOHN P. SURMA JR., 50
CEO since 2004

U.S. STEEL CORP.

» **A CENTURY AFTER** it came to epitomize Big Steel, Pittsburgh's U.S. Steel is back. Thanks largely to China's enormous appetite for steel, which boosted prices around the globe, U.S. Steel swung from a loss in 2003 to a \$1.1 billion profit last year. U.S. Steel didn't just reap the benefits of the economic cycle—it also helped itself by picking up bankrupt National Steel and crafting a cost-cutting labor deal with steelworkers. The new contract not only eliminated jobs but erased retiree obligations at its acquired mills. U.S. Steel also boosted its low-cost operations in Central Europe. After doubling in 2004, prices for U.S. Steel's high-end products have now leveled off. But orders are keeping its mills running flat out. And with \$1 billion in cash, U.S. Steel is shopping for more overseas assets, notably in China. U.S. Steel's stronger numbers may not be enough to keep it independent, however. Some analysts say the company could get acquired by even larger foreign steelmakers eager for a U.S. base.

INDUSTRY
Materials
SALES
\$14 billion
NET INCOME
\$1.1 billion

37

» **JUST TWO YEARS** ago, Zimmer Holdings ranked 26th in *BusinessWeek's* list of hottest small companies. Today, the artificial-joint maker has outgrown that contest, but Zimmer is still hot. Sales and earnings have both climbed at an average annual pace of more than 35% for three years running. Zimmer specializes in making prosthetic knees and hips designed for minimally invasive surgery, which is rapidly gaining acceptance. And the Warsaw (Ind.) company moved into spinal reconstruction through its 2003 takeover of Switzerland's Centerpulse.

38

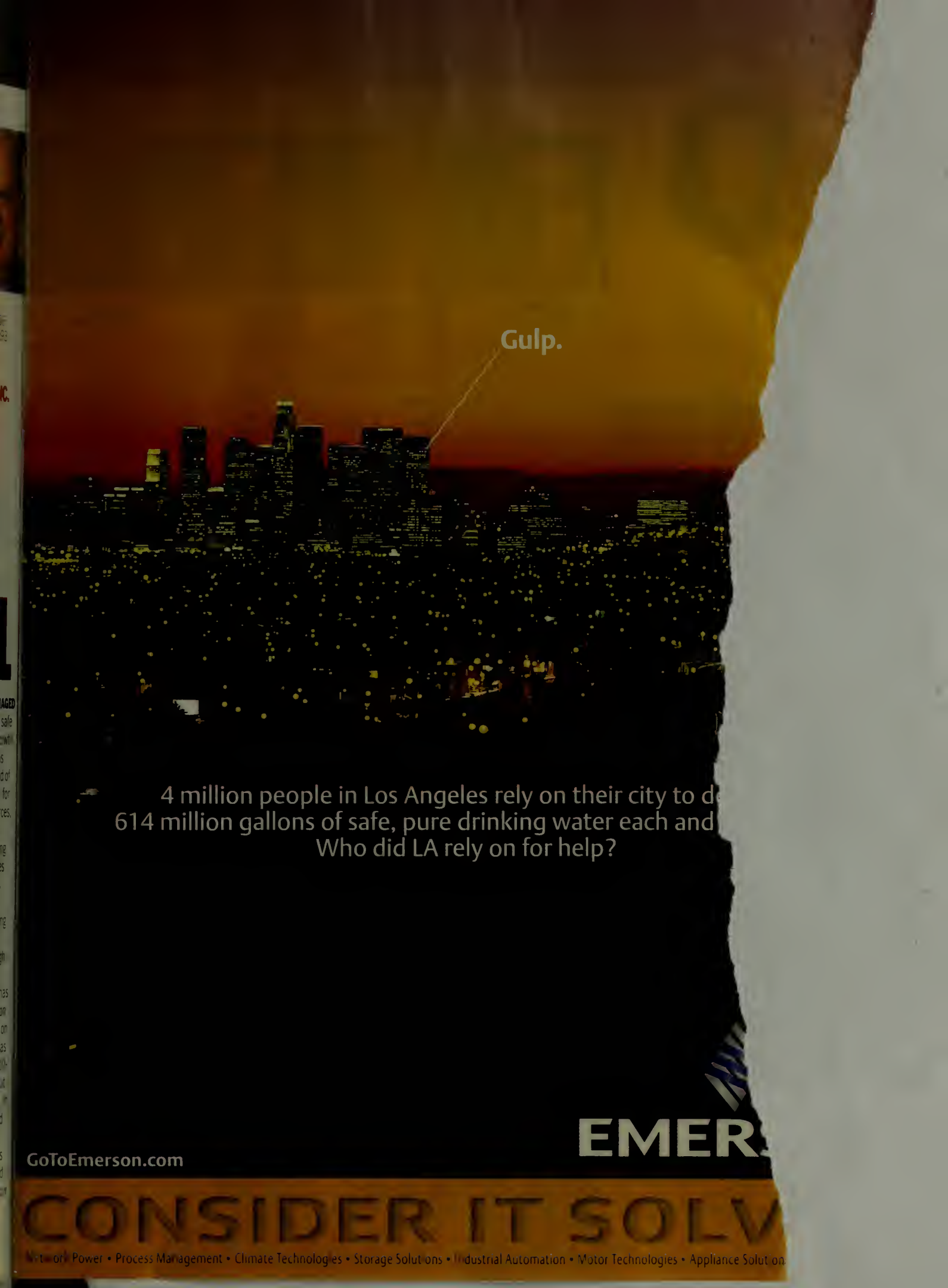
» **AS THE DIGITAL** revolution took hold in the late 1990s, Memphis-based FedEx didn't sit by and wait for its overnight delivery business to be eroded by e-mail and other new technologies. It went on the offensive, snapping up major trucking outfits and extending its "just in time" service into heavier freight and package delivery. Last year, FedEx acquired the Kinko's chain to position itself as the shipping and printing service of choice for home-based entrepreneurs. So even as its overnight document business has slipped, FedEx' diversification paid off in spades: Profits doubled in 2004.

39

» **CHUBB MAKES A** rich living by insuring niche clients, from the homes and cars of the wealthy to specialized businesses doing everything from making medical devices to digging mines. Its near-doubling of earnings last year was skewed by a big year-earlier write-off. Still, CEO Finnegan worked hard to keep Warren (N.J.)-based Chubb in the top tier. He shed problem units, like the one that insured institutional portfolios against loss. And he tightened controls and sharpened underwriting. That's one reason Chubb was a rare insurer scoring double-digit stock returns in the past 12 months.

40

» **XTO HAS MANAGED** to follow a fairly safe route to rapid growth in the oil-and-gas business. Instead of looking far afield for untapped resources, the Fort Worth company is buying up proven patches in places such as Texas and New Mexico and making them more productive through savvy use of technology. That has helped it double, on average, reserves on the properties it has acquired over its 20-year history without breaking the bank. In 2004, XTO plunked down \$2 billion to expand its reserves further. That should help production grow at better than 20% this year.



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614 million gallons of safe, pure drinking water each and every day.
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EMERSON

CONSIDER IT SOLVED

Network Power • Process Management • Climate Technologies • Storage Solutions • Industrial Automation • Motor Technologies • Appliance Solutions

40



H. LAWRENCE CULP JR., 42
CEO since 2001

DANAHER CORP.

INDUSTRY
Capital Goods
SALES
\$6.9 billion
NET INCOME
\$746 million



CHARLES R. WILLIAMSON, 56
CEO since 2001

UNOCAL CORP.

INDUSTRY
Energy
SALES
\$8 billion
NET INCOME
\$1.1 billion



ANDREW N. LIVERIS, 50
CEO since 2004

DOW CHEMICAL CO.

INDUSTRY
Materials
SALES
\$40.2 billion
NET INCOME
\$2.8 billion



JOHN T. CHAMBERS, 55
CEO since 1995

CISCO SYSTEMS INC.

INDUSTRY
Technology Hardware & Equipment
SALES
\$23.6 billion
NET INCOME
\$5.4 billion



ORP.

g and can't
numbers of its
year that ends in

INDUSTRY
Software &
Services
SALES
\$38.5 billion
NET INCOME
\$10 billion

ss in its efforts to
ue growth by
ts—everything from
r running small
: challenges,
post impressive profit
nped profits up 28% in
hs. And it's not just the
:king off that high-margin
doubled efforts to
mployee perks to
stock-based
acing the old stock-option
expenses.

42 43 44 45 46

» **RAPID ACQUI-**
sitions —\$1.7 billion
worth in 2004—
powered Danaher, a
Washington (D.C.)-
based conglomerate
of small industrial
companies. Three
major purchases
helped boost
revenues by 33%.
Sales from existing
businesses grew only
8.5%. That's not too
surprising, given
Danaher's nitty-gritty
product lines, from
hand tools to leak
detectors for oil tanks.
Analysts have
questioned the high
level of goodwill on
Danaher's balance
sheet, and wonder
how the company will
maintain its
acquisition-fueled
growth. Danaher
executives declined to
comment.

» **FOR YEARS,**
Unocal has been
tagged as an
underachiever, as its
oil and gas results
trailed the industry. No
more. Thanks to big
new fields coming on
line in Azerbaijan, the
Gulf of Mexico, and
Bangladesh, Unocal is
expected to boost
production by 4% this
year, while most big oil
companies remain
stagnant. With oil
prices surging, the El
Segundo (Calif.)
company saw
earnings leap 64% in
the past year. Those
lucrative offshore
reserves have made
Unocal a frequently
mentioned takeover
target. That's a big
reason its stock has
returned a hefty
45.2% over the past
12 months.

» **BACK IN 2003, AS**
raw-material costs
shot up unexpectedly,
Dow Chemical broke
long-term sales
contracts so that it no
longer would be
locked into selling at
unprofitable prices.
The move infuriated
Dow's customers but
has paid off big for the
chemical giant. Even
though natural gas
and oil—Dow's raw
materials—cost \$3.4
billion more last year
than in 2003, the
Midland (Mich.)
company was able to
raise prices for
chemicals and
plastics even more.
That boosted net
margins to 7% from
5.3% a year earlier.
Dow vows more price
hikes in 2005 to
expand margins
even further.

» **TRULY, IT'S PRICED**
for perfection.
Despite 19% higher
revenues and profits
that grew by 24% in
the past year, Cisco
saw its stock drop on
fears that it could not
keep up the pace. Not
that the San Jose
(Calif.) company is
doing poorly. Cisco
continues to
dominate basic
corporate networking
gear, and it has a lead
position in security
software, Net
telephony
equipment, and other
new markets. But
industry analysts
wonder how this
behemoth can keep
posting double-digit
growth without
entering markets that
have gross margins
far below Cisco's
65%-plus average.

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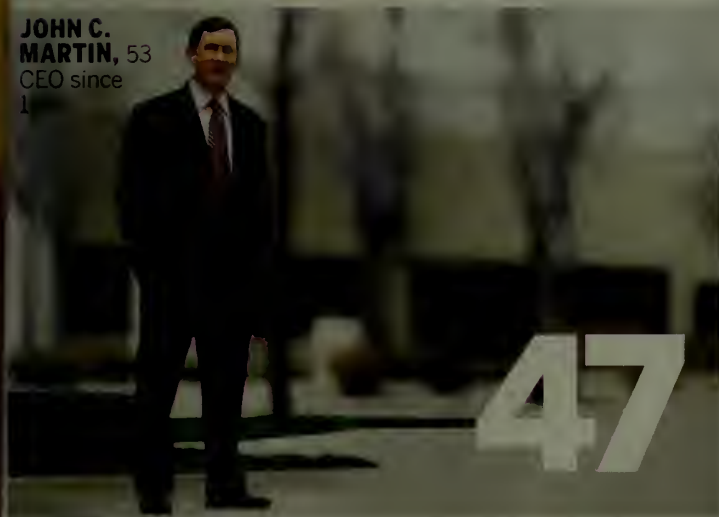
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JOHN C.
MARTIN, 53
CEO since
1



GILEAD SCIENCES INC.

» **GILEAD SCIENCES** has built an emerging biotech brand with its HIV treatments. Sales passed the \$1 billion mark for the first time last year, and unlike so many other biotechs, Gilead has turned its losses into a profit. The Foster City (Calif.) company boasts one of the best net margins in the drug sector: 33.9%. Now, Gilead is set to push further into the \$6 billion HIV market. The European Commission approved Truvada, Gilead's once-a-day treatment that combines its existing drugs Emtriva and Viread. Viread alone upped sales by 38% in 2004, helping to boost the HIV drug's sales to \$908.4 million last year, up from \$576.5 million in 2003. For an encore Gilead is teaming up with Bristol-Myers Squibb Co. to combine Gilead's Truvada with Bristol's Sustiva—the first time patients will be able to take one daily pill, not six, for their complete regimen. But the company will have to keep innovating to fend off competition in the Hepatitis B market. In March an FDA panel praised the efficacy of Baraclude, an emerging Bristol-Myers Squibb rival to Gilead's Hepsera.

INDUSTRY
Pharmaceuticals
& Biotechnology
SALES
\$1.3 billion
NET INCOME
\$449.4 million

47



WILLIAM D. PEREZ, 58
CEO since 2004

NIKE INC.

INDUSTRY
Consumer Durables & Apparel
SALES
\$13.1 billion
NET INCOME
\$1.1 billion

48



JAMES T. HACKETT, 50
CEO since 2003

ANADARKO PETROLEUM CORP.

INDUSTRY
Energy
SALES
\$6.1 billion
NET INCOME
\$1.6 billion

49



KENNETH LEWIS, 57
CEO since 2001

BANK OF AMERICA CORP.

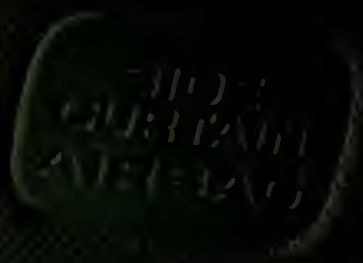
INDUSTRY
Banks
SALES
\$65.4 billion
NET INCOME
\$14.1 billion

50

» **SURE, THE LEBRON** James ads are cool, and the Lance Armstrong spot was inspiring. But what has been moving Nike's stock—up 20% in the year ended Feb. 28—is a focus on nitty-gritty things like supply chain improvements. The Beaverton (Ore.) company posted the highest gross margins last year in its history, 42.9%. Fiscal 2004 net income rose 35%. Demand for pricey basketball and running shoes is surging in the U.S., along with soccer shoes in Europe. With other brands such as Starter, Cole Haan, and Converse picking up steam, new Nike CEO Perez is already ahead of competitors.

» **THIS WILDCATTER** is settling down. A couple of years ago, when far-flung drilling projects produced dry holes and major acquisitions caused indigestion, Anadarko saw its costs balloon and returns shrivel. So Hackett tightened the Houston-based outfit's focus, selling \$3.3 billion of older and costlier properties that represented about 20% of production and using proceeds to pay down debt and buy back shares. Earnings rose 29% last year. He's looking to sustain high single-digit production growth. Even deepwater drilling in the Gulf of Mexico is paying off after years of effort.

» **WHEN BANK OF** America announced its \$47 billion deal for FleetBoston Financial in October, 2003, Wall Street groaned. BofA's stock plunged 10% that day. But in its first year with Fleet, BofA wrung out \$909 million in cost savings even while making a hard push to bring in new customers. The result: Charlotte (N.C.)-based BofA added 184,000 new consumer checking customers and 196,000 new savings accounts last year in Fleet's Northeast stronghold. BofA profits rose 31% last year. Its shares have returned 61.9% over the past three years—not bad for what was once considered a terrible deal.



TC
OF

It all adds up to 5 stars.



First, consider the front side and side curtain airbags. Then, add to that the rigid safety cage. Next, bear in mind the front and rear crush zones. Finally, take into account the Traction Control System (TCS) and anti-lock braking (ABS). And remember, it all comes standard. Just like the 5-star frontal-crash-test safety rating.*

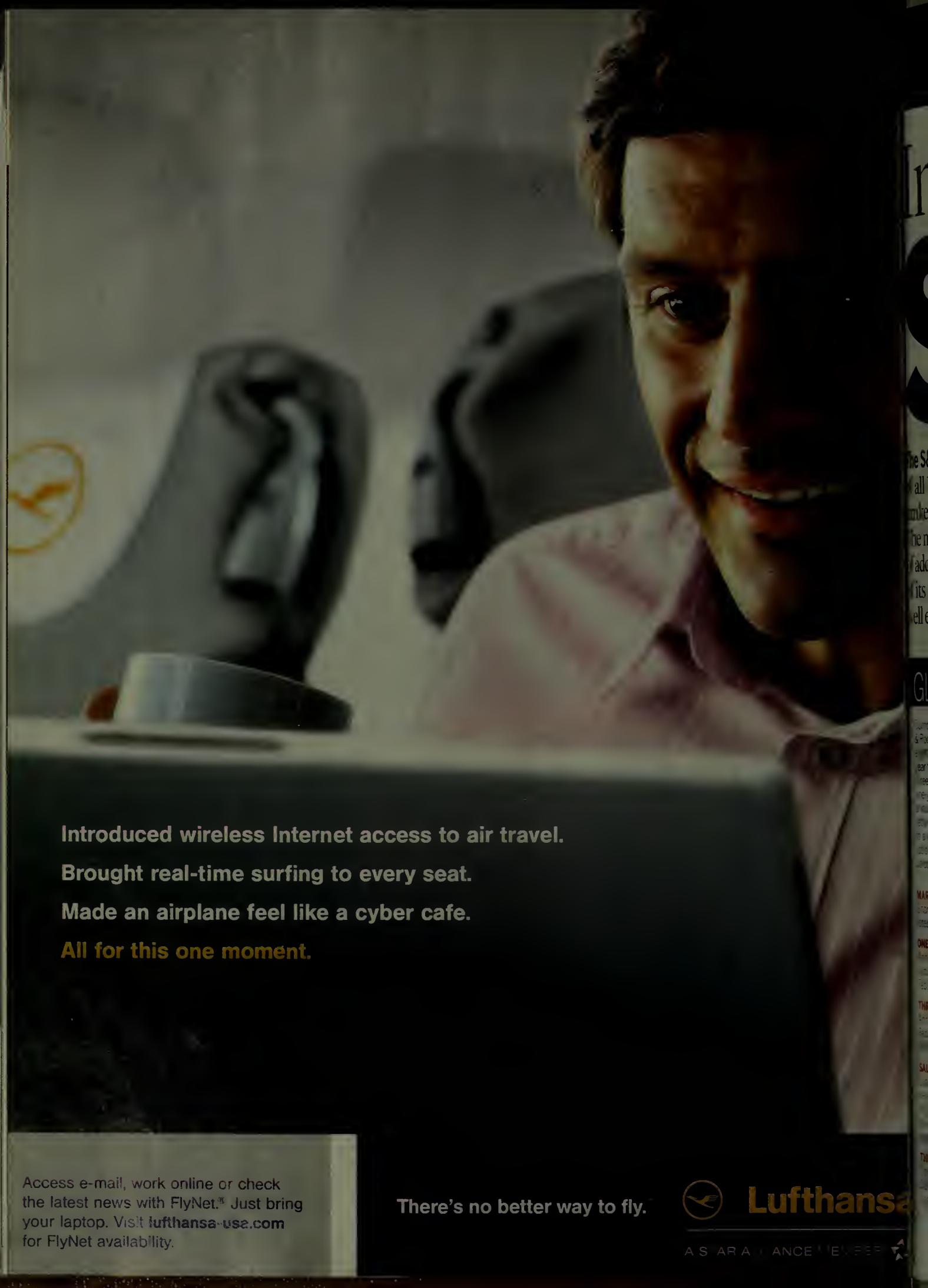


The Accord V-6 Sedan

*National Highway Traffic Safety Administration frontal crash test, February 2003, EX V-6 model shown.

honda.com 1-800-33-Honda ©2004 American Honda Motor Co., Inc.

TCS
OFF

A man with dark hair, wearing a pink and white checkered shirt, is smiling and looking at a laptop screen. The background is blurred, showing the interior of an airplane cabin with other passengers.

Introduced wireless Internet access to air travel.

Brought real-time surfing to every seat.

Made an airplane feel like a cyber cafe.

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AS A R A I A N C E M E M B E R

Industry Ranking

S&P 500

The S&P 500 represents a huge universe, accounting for some 76% of the market capitalization of all U.S. stocks. To find out how each of the companies measures up against its peers, we ranked them within industry groups, using the same factors that go into their overall ranking. The numbers used in our proprietary formula are shown in these tables, along with a wealth of additional financial information. Each company's rank within its industry is listed to the left of its name, followed by its overall rank. Taken together, the two ranks offer a picture of how well each company harnesses its resources, given the unique constraints of its industry.

GLOSSARY & FOOTNOTES

Companies on this list are from the Standard & Poor's 500. Each company is ranked by eight criteria: one-year total return; three-year total return; one-year sales growth; three-year average annual sales growth; one-year profit growth; three-year average annual profit growth; net profit margins; and return on equity, with additional weight given to a company's sales and debt-to-capital ratio. A company's composite rank is calculated using the sum of all of its ranks.

MARKET VALUE

Share price on Feb. 28, 2005, multiplied by the latest available common shares outstanding.

ONE-YEAR TOTAL RETURN

Annual dividend per share, reinvested, plus Feb. 28, 2005, price per share, as a percent of Feb. 27, 2004, price per share.

THREE-YEAR TOTAL RETURN

Annual dividend per share, reinvested, plus Feb. 28, 2005, price per share, as a percent of Feb. 28, 2002, price per share.

SALES

Latest available sales through the most recent 12 months ended Jan. 31, 2005. Includes all sales and other operating revenues. For banks, this includes all banking operations revenues.

THREE-YEAR SALES GROWTH

Calculated using the least squares method. Data for 2004 and 2003 are as reported by company in 2004.

PROFITS

Latest available profits through the most recent 12 months ended Jan. 31, 2005. Net income from continuing operations before extraordinary items.

THREE-YEAR PROFITS GROWTH

Calculated using the least squares method. Data for 2004 and 2003 are as reported by company in 2004. If results for one of the earliest three years are negative or not available, the average is for two years.

NET MARGINS

Net income from continuing operations before extraordinary items as a percent of sales.

RETURN ON INVESTED CAPITAL

Net income available for shareholders as a percent of debt and equity funds.

RETURN ON EQUITY

Net income available for shareholders divided by total equity.

RECENT SHARE PRICE

Price for a single share of a company's most widely traded issue of common stock as of the close of trading Feb. 28, 2005.

HIGH/LOW PRICE

Trading range for the company's common stock, Feb. 27, 2004, to Feb. 28, 2005.

P-E RATIO

Price-earnings ratio based on latest 12 months' earnings and Feb. 28, 2005, stock price.

DIVIDEND YIELD

Annual dividend rate as a percent of the Feb. 28 stock price.

EARNINGS PER SHARE

Diluted earnings per share, excluding extraordinary profit or loss, divided by number of common and common equivalent shares.

EARNINGS PER SHARE ESTIMATES

Analysts' consensus estimates for 2004 compiled as of Feb. 28, 2005, by Thomson First Call.

(a) Data as of September, 2004.

(b) Data as of October, 2004.

(c) Total return from May 5, 2004.

(d) Total return from December 3, 2004.

(e) Two-year growth rate.

(x) Sales include excise taxes.

(y) Sales include other income.

(z) Sales include excise taxes and other income. NA=not available. NC=not calculable. NM=not meaningful. NR=not ranked. INC=incomplete.

† Because *BusinessWeek* is owned by The McGraw-Hill Companies, the S&P 500 Scoreboard does not include a forecast of the company's earnings.

Note: Compustat data provided by Standard & Poor's, from sources such as statistical services, registration statements, and company reports that S&P believes to be reliable but are not guaranteed by S&P or *BusinessWeek* as to correctness or completeness. This material is not an offer to buy or sell any security.

Additional data: Thomson First Call.

RANK		COMPANY	MARKET VALUE			SALES			PROFITABILITY	
INDUSTRY RANK	S&P 500 RANK		FEB. 23 2005 \$ MIL.	TOTAL RETURN 1 YEAR	TOTAL RETURN 13 YEAR	12 MONTH 2004 \$ MIL.	CHANGE FROM 2003	3 YEAR AVERAGE CHANGE	12 MONTH 2004 \$ MIL.	CHANGE FROM 2003

1 AUTOMOBILES & COMPONENTS

Industry Average			9294.5	-3.3	-13.9	52537.1	5	2.3	818.1	181
1	128	Harley-Davidson	18180.2	17.3	22.4	5320.5 _y	8	14.0	889.8	17
2	170	Johnson Controls	11298.4	3.0	39.9	27144.8	14	13.3	813.5	16
3	207	Ford Motor	23149.5	-5.3	-6.2	170839.0	4	1.9	3634.0	303
4	321	General Motors	20147.0	-22.1	-22.3	193452.0 _y	4	3.1	3691.0	29
5	395	Goodyear Tire & Rubber	2536.3	71.7	-45.9	17447.8 _a	19	7.0	-446.7	NM
6	447	Dana	2160.0	-30.6	-19.1	8990.0 _y	11	-6.2	95.0	-46
7	450	Delphi	3855.4	-30.6	-53.1	28867.0 _a	4	2.8	148.0	NM
8	463	Cooper Tire & Rubber	1451.6	-1.1	77	2081.6	12	-16.8	27.4	11
9	473	Visteon	872.3	-32.2	-48.8	18691.0	6	1.0	-1489.0	NM

2 CONSUMER DURABLES & APPAREL

Industry Average			6752.8	17.3	64.6	6622.4	13	9.5	406.0	24
1	12	Pulte Homes	9951.8	48.4	203.4	11711.2	30	28.6	998.0	61
2	17	Coach	10605.8	40.1	345.5	1527.0	36	33.4	325.8	63
3	48	Nike	22963.5	20.0	52.4	13101.2	16	10.8	1094.0	35
4	56	KB Home	4906.0	74.8	193.6	7052.7	21	15.6	480.9	30
5	62	Centex	8021.2	19.5	144.8	12062.2 _y	22	17.3	909.6	29
6	65	Black & Decker	6807.3	62.9	77.3	5398.4	20	7.7	441.1	54
7	72	Fortune Brands	11676.4	15.2	88.4	7021.2	19	10.5	783.8	35
8	79	Brunswick	4483.2	20.0	82.1	5229.3	27	15.3	269.8	100
9	132	VF	6602.8	35.8	52.8	6054.5 _y	16	4.8	474.7	19
10	226	Liz Claiborne	4579.1	15.3	42.3	4632.8	9	10.7	313.6	12
11	235	Stanley Works	3804.5	22.4	-0.6	3043.4	20	4.5	240.2	164
12	251	Reebok International	2573.1	11.8	61.5	3785.3	9	8.5	192.4	22
13	268	Mattel	8677.6	12.6	15.6	5102.8	3	2.7	572.7	7
14	270	Whirlpool	4271.3	-10.2	-8.7	13220.0	9	8.7	406.0	-2
15	273	Leggett & Platt	5282.2	15.6	15.7	5085.5	16	6.9	285.4	39
16	373	Hasbro	3737.7	-2.2	51.9	2999.2	-4	2.6	196.2	12
17	375	Eastman Kodak	9744.8	21.2	20.5	13517.0	5	0.7	187.0	-6
18	388	Snap-on	1911.6	6.7	5.9	2407.2	8	4.1	81.7	4
19	437	Jones Apparel Group	3882.3	-13.9	-9.3	4649.7	6	3.8	301.8	-8
20	483	Newell Rubbermaid	6116.4	-9.6	-21.1	6748.4	-2	-1.5	-19.1	NM
21	492	Maytag	1210.3	-44.0	-58.4	4721.5	-1	4.0	-9.3	NM

3 HOTELS, RESTAURANTS & LEISURE

Industry Average			16486.3	22.9	64.5	7170.3	16	12.8	687.7	38
1	27	Carnival	43721.5	23.9	107.4	9727.0	45	31.2	1854.0	55
2	33	Starbucks	20869.3	38.5	125.2	5602.6	29	26.1	424.8	42
3	95	McDonald's	41588.2	19.0	32.7	19064.7	11	8.9	2278.5	51
4	125	Marriott International	14473.8	44.6	66.0	10099.0	12	0.5	594.0	25
5	141	YUM! Brands	14146.2	32.7	66.2	9011.0	8	8.9	740.0	20
6	162	Starwood Hotels & Resorts	11947.8	48.8	70.9	5368.0	16	9.6	369.0	251
7	192	International Game Technology	10568.9	-21.4	84.3	2517.9	12	26.0	435.5	7

INVESTMENT DATA									
	NET MARGIN %	RETURN ON INVESTED CAPITAL	RETURN ON COMMON EQUITY	RECENT SHARE PRICE \$	12-MONTH HIGH/LOW \$	P-E RATIO	DIVIDEND YIELD	EARNINGS PER SHARE 2004	ESTIMATED EARNINGS PER SHARE 2005
5	0.6	-4.7	12.5	26	31/22	98	2.71	0.26	1.63
	15.5	22.1	27.6	62	64/50	21	0.81	3.00	3.36
0	3.0	10.8	14.6	59	64/50	14	1.69	4.21	4.66
	0.6	1.9	23.1	13	16/12	7	3.16	1.80	1.76
0	1.5	1.1	12.9	36	50/35	5	5.61	6.51	3.79
5	-10.8	-9.0	NM	14	16/7	-6	0.00	-2.56	0.70
1	2.2	2.1	3.9	14	22/14	23	3.33	0.63	1.43
5	-0.1	3.7	9.7	7	11/7	25	4.08	0.27	-0.59
3	1.3	1.4	2.3	19	24/17	52	2.17	0.37	0.58
0	-6.7	-76.5	-343.1	7	12/7	-1	3.58	-11.88	-1.06
1	5.6	11.9	18.0	52	55/37	15	1.69	3.43	4.16
5	6.9	13.5	22.1	78	79/45	10	0.26	7.67	9.00
3	17.8	31.3	33.0	56	58/36	33	0.00	1.67	1.88
4	7.2	18.1	20.5	87	92/66	21	1.15	4.05	4.94
8	6.3	11.4	23.4	125	126/60	11	1.20	11.40	14.54
5	7.2	7.2	23.7	64	66/40	9	0.25	7.04	8.60
2	6.4	16.0	28.3	83	90/51	15	1.35	5.40	6.08
2	9.8	16.2	24.4	81	85/68	15	1.63	5.23	5.19
2	3.3	11.1	15.8	47	50/35	17	1.29	2.77	3.28
3	7.6	15.3	18.6	60	61/43	14	1.81	4.21	4.59
8	6.6	13.6	17.3	42	44/32	15	0.53	2.85	3.13
9	3.6	14.2	19.8	46	49/36	16	2.42	2.85	3.22
1	4.5	12.1	15.7	44	46/31	14	0.68	3.05	3.42
2	10.8	20.6	24.0	21	21/16	15	2.15	1.35	1.29
1	3.4	14.3	25.2	64	74/55	11	2.70	5.90	5.76
6	4.7	9.2	12.3	28	31/22	19	2.17	1.45	1.64
5	5.6	10.1	12.0	21	23/17	22	1.71	0.96	1.24
4	1.5	3.3	4.9	34	35/24	52	1.47	0.65	2.60
4	3.5	6.1	7.4	33	35/27	24	3.02	1.40	1.67
5	7.5	8.2	11.4	32	40/32	13	1.26	2.39	2.78
3	3.1	-0.5	-1.1	22	26/19	-318	3.77	-0.07	1.44
2	2.4	-1.0	NM	15	32/15	-127	4.72	-0.12	1.10
6	8.0	10.2	14.7	45	50/32	27	1.03	1.67	2.11
1	17.8	8.4	11.8	54	59/40	24	1.10	2.24	2.77
6	6.9	15.1	15.2	52	64/37	50	0.00	1.03	1.17
0	8.8	10.5	17.6	33	33/25	18	1.66	1.79	2.03
9	5.3	12.1	14.6	64	67/41	26	0.53	2.47	2.83
2	7.4	22.2	46.4	49	49/35	20	0.82	2.42	2.62
9	2.3	4.3	7.7	57	61/37	33	1.47	1.72	2.05
3	18.1	15.2	21.0	30	47/28	26	1.58	1.18	1.34

Rev Those Engines

U.S. carmakers could learn a thing or two from **HARLEY-DAVIDSON INC.** (No. 128). Twenty-five years ago, the motorcycle maker was down for the count against far stronger Japanese competition. Management bought the company from a lackluster parent and buckled down to boost quality and create a brand around the biker lifestyle. Harley's success since then is legendary. But now growth is slowing—profits increased 17% in the past year, down from the company's three-year average of 27%. To kick-start performance, Harley must get more women and younger riders interested in its bikes.



RANK	COMPANY		MARKET VALUE			SALES			PROFITABILITY	
			FEB. 28, 2005 \$ MIL.	TOTAL RETURN (1 YEAR)	TOTAL RETURN (3 YEAR)	12 MONTH 2004 \$ MIL.	CHANGE FROM 2003 %	3-YEAR AVERAGE CHANGE %	12 MONTH 2004 \$ MIL.	CHANGE FROM 2003 %
8	240	Harrah's Entertainment	7343.3	29.2	69.2	4548.3	15	5.9	329.5	26
9	316	Hilton Hotels	8129.7	31.9	66.2	4195.0	9	1.5	238.0	45
10	357	Darden Restaurants	4257.7	10.2	-3.9	5109.1	6	7.1	243.8	12
11	414	Wendy's International	4303.3	-5.7	25.7	3630.4	15	15.0	57.8	-76

4 MEDIA

Industry Average			27003.1	-7.9	-5.2	11357.3	8	7.0	-259.8	NM
1	150	Walt Disney	55824.1	6.2	25.2	30869.0	9	8.0	2380.0	24
2	156	McGraw-Hill	17434.3	19.3	46.5	5250.5	7	4.3	756.4	10
3	206	Omnicom Group	16968.8	12.6	0.9	9747.2	13	12.5	723.5	15
4	247	Univision Communications	8529.4	-25.9	-36.0	1786.9	36	25.6	255.9	65
5	289	Gannett	20029.7	-7.6	7.2	7381.3 _y	10	5.1	1317.2	9
6	296	Comcast	71803.8	8.4	-4.2	20307.0	11	34.9	970.0	NM
7	336	Meredith	2293.5	-7.9	19.5	1192.0	5	6.2	123.0	38
8	355	Time Warner	79063.3	-0.1	-30.5	42089.0	6	3.4	3209.0	2
9	387	Tribune	12966.7	-17.4	-1.8	5726.2	2	3.0	573.3	-36
10	397	Knight-Ridder	4997.7	-10.6	2.5	3014.1	2	1.5	326.2	10
11	421	Clear Channel Communications	19087.4	-21.7	-27.4	9418.5	5	5.8	845.8	-26
12	422	New York Times	5329.1	-18.5	-13.2	3303.6	2	3.3	292.6	-3
13	436	Viacom	60258.3	-8.6	-24.1	22525.9	8	-2.5	-15059.5	NM
14	464	Dow Jones	3040.0	-22.0	-28.7	1671.5	8	-1.8	99.5	-42
15	487	Interpublic Group	5550.3	-22.5	-51.0	6077.4 _a	5	-4.8	-709.7	NM
INC	INC	News Corp	48873.2	-10.9	31.2	NA	NA	NA	NA	NA

5 RETAILING

Industry Average			15187.4	11.3	37.9	15671.2	8	8.2	719.2	1	6
1	19	eBay	57346.0	24.7	229.2	3271.3	51	64.9	778.2	74	10
2	61	Staples	15644.4	21.5	61.5	14448.4	11	10.5	708.4	45	0
3	64	Lowe's	45495.7	5.3	30.8	36464.0	18	18.0	2176.0	19	24
4	80	Nordstrom	7522.8	39.0	121.2	7304.3 _y	11	8.2	393.5	62	9
5	83	Best Buy	17722.6	2.2	22.0	26655.0	15	13.5	881.0	24	23
6	89	Home Depot	87843.9	11.2	-18.0	73094.0	13	11.0	5001.0	16	0
7	120	Bed Bath & Beyond	11353.8	-8.3	12.3	4978.0	18	21.2	468.2	30	34
8	140	Gap	18931.9	3.0	81.0	16267.0	3	5.9	1141.0	11	5
9	164	J.C. Penney	12074.6	46.1	142.5	18424.0	4	-20.2	667.0	83	6
10	167	Sherwin-Williams	6261.7	28.7	77.8	6113.8	13	6.2	393.3	18	1
11	173	OfficeMax	2783.0	-4.7	-6.6	12934.1 _a	68	18.1	181.8	1008	7
12	176	Dollar General	6956.4	-2.2	47.5	7429.9 _b	11	12.8	313.1	2	5
13	182	TJX	11767.3	4.5	31.3	14913.5	12	11.6	664.1	1	5
14	201	Target	45265.4	16.4	23.8	46839.0 _y	11	4.5	1885.0	16	0
15	215	Kohl's	16420.3	-7.0	-29.3	11700.6	14	15.7	730.4	26	1
16	222	Limited Brands	9664.8	29.7	48.8	9408.3	5	0.7	738.7	3	1
17	250	Genuine Parts	7558.0	28.6	31.3	9097.3	8	3.3	395.6	12	0
18	265	Office Depot	6011.8	10.4	1.3	13564.7	10	7.2	338.2	12	1

				INVESTMENT DATA					
	NET WORTH 2003	RETURN ON INVESTED CAPITAL	RETURN ON COMMON EQUITY	RECENT SHARE PRICE \$	12-MONTH HIGH/LOW \$	P/E RATIO	DIVIDEND YIELD	EARNINGS PER SHARE 2004	ESTIMATED EARNINGS PER SHARE 2005
1	6.6	4.7	16.8	66	70/44	22	2.01	2.92	3.58
7	4.3	3.8	9.7	21	23/15	35	0.38	0.60	0.74
1	4.5	13.8	19.2	27	30/19	18	0.30	1.48	1.87
5	7.5	2.2	3.1	38	43/32	76	1.43	0.50	2.23
	7.7	7.2	-1.6	43	50/38	36	1.07	1.20	2.22
7	6.7	6.3	9.0	28	30/21	24	0.86	1.15	1.29
4	14.1	25.3	25.3	92	95/73	23	1.44	3.92	†
4	7.3	11.7	19.9	91	91/66	23	0.99	3.88	4.35
3	11.9	3.7	4.8	26	37/26	37	0.00	0.72	0.87
3	18.0	10.2	16.1	79	91/78	16	1.37	4.92	5.18
8	-1.2	1.6	2.3	32	34/26	75	0.00	0.43	0.56
3	79	15.4	19.8	46	56/46	19	1.22	2.38	2.50
6	8.0	3.6	5.3	17	20/15	25	0.00	0.68	0.76
0	15.9	6.1	8.4	41	52/39	24	1.77	1.72	2.38
8	10.1	10.9	22.4	66	80/62	16	2.11	4.13	4.11
0	12.8	5.0	8.9	33	45/30	24	1.50	1.41	1.51
9	9.4	15.4	22.4	37	47/36	19	1.69	1.96	1.89
9	10.7	-20.6	-23.7	35	42/30	-4	0.80	-8.78	1.72
0	11.0	30.9	81.7	37	50/37	31	2.70	1.21	1.28
7	-76	-171	-36.2	13	17/10	-7	0.00	-176	0.61
IA	NA	NA	NA	17	19/15	NA	0.60	NA	NA
6	4.9	12.7	15.9	37	41/28	20	0.87	1.87	2.17
8	20.7	11.6	11.6	43	59/32	75	0.00	0.57	0.76
9	3.8	15.2	17.2	32	34/24	23	0.79	1.40	1.63
0	5.9	14.9	18.9	59	61/46	22	0.27	2.71	3.31
4	3.7	14.0	21.0	54	54/35	19	0.97	2.77	3.35
3.3	3.1	19.9	22.2	54	62/44	20	0.82	2.66	3.38
8	6.6	19.0	20.7	40	44/32	18	1.00	2.26	2.56
0.4	8.5	19.8	19.8	38	44/34	25	0.00	1.53	1.90
0	6.5	16.4	22.5	21	26/18	18	0.42	1.20	1.42
3.6	2.0	8.0	13.5	44	45/31	20	1.12	2.23	3.09
5.4	6.1	19.0	25.0	44	47/34	16	1.85	2.72	3.07
1.4	0.2	4.1	6.7	32	38/28	17	1.90	1.86	1.13
1.2	4.6	16.5	19.9	21	23/17	23	0.75	0.93	1.16
4.5	4.9	29.8	40.2	24	27/21	19	0.74	1.30	1.54
0	3.9	8.5	14.5	51	54/40	25	0.63	2.07	2.54
5.2	5.7	12.0	14.7	48	54/40	23	0.00	2.12	2.47
7.9	8.0	13.2	16.6	24	28/18	15	2.52	1.54	1.59
4.3	4.2	12.8	15.5	43	45/33	19	2.89	2.25	2.44
2.5	2.4	8.8	10.3	19	20/14	18	0.00	1.07	1.29

More Magic Needed

A new head mouse is taking over, just as **WALT DISNEY CO.** (No. 150) begins to show signs of a rebound. Outgoing CEO Michael Eisner boosted earnings in the past year by 24%, to \$2.4 billion, on the strength of its *Finding Nemo* DVD, a stream of foreign visitors to its theme parks, and good ratings from ABC's hit *Desperate Housewives*. But Disney's stock hovers near its 1997 price, as Eisner controversies drive away investors. Robert Iger, set to become CEO on Oct. 1, must decide whether to re-up with the NFL for more *ABC Monday Night Football* and how much to pay to remain partners with hit factory Pixar Animation.

ROGER KENNY

RANK	INDUSTRY RANK	COMPANY	MARKET VALUE			SALES			PROFITABILITY	
			FEB. 28, 2005 \$ MIL.	TOTAL RETURN (1 YEAR)	TOTAL RETURN 3-YEAR	12-MONTH 2004 \$ MIL.	CHANGE FROM 2003 %	3-YEAR AVERAGE CHANGE %	12-MONTH 2004 \$ MIL.	CHANGE FROM 2003 %
19	282	AutoZone	7714.0	8.0	46.0	5641.2	2	4.4	567.0	6
20	284	Tiffany	4394.5	-27.8	-6.4	2204.8 _y	10	11.7	304.3	41
21	297	Family Dollar Stores	5520.3	-12.5	3.1	5417.5	11	12.5	253.6	0
22	335	Circuit City Stores	2989.2	40.5	35.2	10154.0	5	2.1	72.1	NM
23	338	AutoNation	5161.0	17.1	56.4	19424.7	4	-1.3	396.4	-23
24	353	Federated Department Stores	9551.6	8.9	37.3	15630.0 _y	2	-0.2	689.0	-1
25	361	RadioShack	4676.4	-13.8	10.5	4841.2	4	0.6	337.2	13
26	376	Dillard's	1913.6	33.4	19.0	7768.7 _{by}	-3	-3.1	60.2	98
27	380	May Department Stores	10076.4	1.4	4.6	14441.0 _y	8	0.4	524.0	21
28	383	Toys 'R' Us	4918.4	45.7	28.4	11231.0 _b	-1	0.6	152.0	-22
29	431	Sears, Roebuck	10769.4	8.0	1.4	36099.0	-12	-3.8	332.0	-90
30	462	Big Lots	1312.2	-19.0	-7.4	4375.1	5	8.4	32.3	-64

6 FOOD & STAPLES RETAILING

Industry Average			40009.4	3.7	5.8	65079.1	10	6.8	1788.0	13
1	74	CVS	19979.8	33.7	86.5	30594.3	15	11.1	959.3	13
2	77	Walgreen	43734.6	20.7	8.0	38676.5	15	14.7	1438.0	20
3	122	Costco Wholesale	21984.6	21.0	14.0	49163.5 _y	12	11.3	915.4	24
4	199	Sysco	21909.9	-11.8	21.5	30027.8	9	10.2	935.0	11
5	209	Wal-Mart Stores	218561.5	-12.5	-15.0	288189.0 _y	11	9.7	10267.0	16
6	210	Supervalu	4277.9	14.5	31.8	19996.5	1	-1.5	388.5	56
7	433	Albertson's	8239.5	-6.5	-18.3	37469.0 _b	5	0.5	418.0	-33
8	439	Safeway	8228.5	-19.5	-57.2	35822.9	0	2.3	560.2	NM
9	440	Kroger	13168.7	-6.4	-18.8	55772.0 _b	5	3.3	211.0	-80

7 FOOD, BEVERAGE & TOBACCO

Industry Average			28040.7	13.9	35.3	14692.3	7	6.9	1546.9	29
1	94	Archer Daniels Midland	15808.5	42.4	83.4	37030.9	12	20.9	703.5	21
2	98	PepsiCo	90430.9	5.5	11.5	29261.0	8	7.5	4174.0	17
3	133	Wm. Wrigley Jr.	14960.8	20.1	24.3	3648.6	19	14.6	493.0	11
4	148	Altria Group	134739.1	20.3	48.1	63963.0	6	-0.2	9420.0	3
5	152	Hershey Foods	15503.0	54.6	88.6	4429.2	6	2.2	590.9	27
6	184	Kellogg	18172.0	14.8	38.3	9613.9	9	8.2	890.6	13
7	186	General Mills	19062.7	16.8	22.1	11249.0	4	27.5	1070.0	7
8	198	Coca-Cola	103119.7	-12.4	-4.3	21962.0	4	7.8	4847.0	12
9	203	Reynolds American	12082.2	40.3	56.5	6437.0	22	-0.9	627.0	NM
10	225	UST	9029.9	51.2	85.8	1838.2	6	5.0	538.1	67
11	232	Sara Lee	17681.0	6.2	18.3	19943.0	7	5.5	1408.0	27
12	267	McCormick	5147.6	23.5	63.3	2526.2	11	5.1	214.5	8
13	271	Brown-Forman	6198.8	6.1	58.8	2330.9 _y	7	6.1	308.4	19
14	293	Anheuser-Busch	37488.7	-9.2	-1.9	14934.2	6	4.9	2240.3	8
15	299	H.J. Heinz	13148.7	1.5	13.3	8795.2	6	2.2	729.0	7
16	320	Pepsi Bottling Group	6777.8	-5.4	10.5	10906.0	6	9.2	457.0	8
17	325	Campbell Soup	11301.6	1.5	11.8	7414.0	5	8.1	666.0	3
18	337	Molson Coors Brewing	6075.2	4.0	19.8	4305.8	8	19.4	196.7	13

INVESTMENT DATA

	NET MARGIN 2003	RETURN ON INVESTED CAPITAL	RETURN ON COMMON EQUITY	RECENT SHARE PRICE \$	12-MONTH HIGH/LOW \$	P-E RATIO	DIVIDEND YIELD	EARNINGS PER SHARE 2004	ESTIMATED EARNINGS PER SHARE 2005
1	9.7	27.0	204.4	97	98/70	14	0.00	6.77	7.41
8	10.8	14.5	179	30	43/27	15	0.80	2.05	1.62
7	5.2	18.0	18.0	33	39/25	22	1.15	1.49	1.53
7	-0.3	3.5	3.5	16	18/10	46	0.45	0.34	0.60
0	2.8	7.8	9.3	20	20/15	13	0.00	1.45	1.49
4	4.5	7.8	11.2	56	60/43	15	0.96	3.86	4.60
3	6.4	23.6	36.6	30	35/26	14	0.85	2.08	2.34
8	0.4	1.6	2.7	23	28/15	32	0.69	0.72	0.96
6	3.3	4.9	10.8	35	36/23	20	2.84	1.70	2.03
4	1.7	2.3	3.6	23	23/13	32	0.00	0.71	1.06
9	8.3	3.5	5.5	50	56/31	33	1.84	1.53	2.19
7	2.2	2.3	3.2	12	16/11	42	0.00	0.28	0.55
7	2.7	10.6	17.5	35	39/29	21	1.11	1.66	1.94
1	3.2	10.6	13.4	50	50/34	22	0.58	2.30	2.65
7	3.6	17.1	17.1	43	44/32	31	0.49	1.39	1.53
9	1.7	10.0	11.1	47	50/35	24	0.86	1.92	2.11
1	3.1	23.7	32.9	34	41/29	24	1.74	1.43	1.49
6	3.4	13.8	20.9	52	61/51	21	1.01	2.41	2.73
9	1.3	9.7	16.0	32	35/26	11	1.92	2.84	2.51
1	1.8	3.4	7.8	22	27/22	20	3.39	1.13	1.63
6	-0.5	5.4	13.0	18	26/17	15	0.00	1.25	1.49
4	1.9	1.8	4.9	18	20/15	64	0.00	0.28	1.30
5	8.8	17.7	27.9	46	50/37	18	2.43	2.51	2.73
9	1.8	5.8	8.2	24	25/15	22	1.41	1.08	1.55
3	13.2	26.2	30.8	54	56/47	22	1.71	2.41	2.56
5	14.5	22.6	22.6	67	72/56	30	1.68	2.19	2.44
7	15.2	20.0	30.7	66	69/45	14	4.45	4.57	5.14
3	11.1	33.2	54.2	63	63/41	27	1.40	2.30	2.32
3	8.9	14.5	39.5	44	46/38	21	2.30	2.14	2.34
5	9.3	7.9	21.5	52	54/43	19	2.37	2.79	3.13
2.1	20.7	28.4	30.4	43	54/38	21	2.62	2.00	2.06
0.7	-70.0	8.1	10.2	82	89/53	15	4.64	5.62	7.16
0.3	18.6	63.3	5625.2	55	55/35	17	4.03	3.23	3.35
0.1	5.9	17.2	39.0	22	25/21	13	3.53	1.76	1.51
3.5	8.8	15.5	24.1	38	39/31	25	1.69	1.52	1.73
3.2	11.9	16.7	24.8	51	51/43	20	1.93	2.52	2.70
5.0	14.7	20.5	84.0	47	55/47	17	2.07	2.77	2.74
3.3	8.3	10.7	33.7	38	41/35	18	3.03	2.06	2.49
4.2	4.1	6.6	23.4	27	31/26	16	0.74	1.73	1.80
0.0	9.2	17.1	49.7	28	31/25	17	2.46	1.61	1.67
4.6	4.4	8.0	13.0	70	80/64	13	1.84	5.19	4.96

Putting The Pep Back

PEPSICO (No. 98) has proved adept at creating opportunities where others see peril. Even as its share of the U.S. soft drink market shrank, Pepsi came up with innovative answers to trends such as the low-carb craze and blossoming ethnic tastes. CEO Steven Reinemund also has tried to stay ahead of public sentiment, by curbing advertising to children and removing trans fats from Pepsi's Frito Lay products. Still, investors are nervous about the lack of fizz in core Pepsi products. That's why the stock delivered tepid 5.5% returns in the past year. And it's a big reason for Pepsi's drop from No. 44 last year.



RANK	COMPANY	MARKET VALUE			SALES			PROFITABILITY	
		FEB. 28, 2005 \$ MIL.	TOTAL RETURN (1 YEAR)	TOTAL RETURN (3 YEAR)	12-MONTH 2004 \$ MIL.	CHANGE FROM 2003 %	3-YEAR AVERAGE CHANGE %	12-MONTH 2004 \$ MIL.	CHANGE FROM 2003 %
19	372 ConAgra Foods	14069.8	4.4	31.7	15099.7	6	-19.7	767.4	-6
20	393 Coca-Cola Enterprises	10016.0	-7.8	25.3	18158.0	5	5.5	596.0	-12

8 HOUSEHOLD & PERSONAL PRODUCTS

Industry Average		39679.5	16.8	39.7	15113.9	12	7.6	1902.3	16
1	58 Procter & Gamble	133924.8	5.6	33.5	54187.0	15	11.5	6942.0	20
2	69 Gillette	49898.3	32.6	55.4	10477.0	13	9.1	1691.0	23
3	87 Avon Products	20228.2	22.9	74.0	7747.8	13	9.2	846.1	27
4	179 Alberto-Culver	4765.2	28.3	54.2	3340.8	13	10.9	189.4	48
5	219 Kimberly-Clark	31861.7	6.2	15.1	15083.2	8	4.2	1770.4	8
6	318 Colgate-Palmolive	27869.0	-2.8	-0.6	10584.2	7	5.4	1327.1	-7
7	374 Clorox	9209.3	24.9	46.1	4377.0y	7	3.2	550.0	13

9 ENERGY

Industry Average		34973.2	56.0	99.3	28674.1	24	15.3	2393.6	52
1	2 ConocoPhillips	77043.5	64.5	103.2	118719.0	31	74.1	8107.0	77
2	3 ChevronTexaco	131523.4	44.8	63.5	142897.0	27	14.3	13034.0	77
3	4 Valero Energy	18241.3	139.2	242.3	54618.6	44	51.4	1803.8	190
4	6 Occidental Petroleum	27737.1	61.7	185.2	11368.0	23	13.3	2606.0	63
5	7 Exxon Mobil	405247.3	53.4	65.0	270764.0y	21	14.1	25330.0	21
6	10 Apache	20528.5	53.6	155.3	5308.0	26	27.0	1670.1	52
7	11 Devon Energy	22646.4	65.8	117.3	9189.0	25	49.6	2186.0	26
8	18 Sunoco	7246.8	63.7	175.5	23186.0	45	23.9	615.0	97
9	20 Burlington Resources	19430.0	71.0	173.1	5618.0	30	20.5	1527.0	21
10	31 EOG Resources	10836.6	105.6	162.3	2268.9	30	15.2	624.9	43
11	41 XTO Energy	11846.1	91.4	308.9	1950.3	64	33.8	507.9	77
12	44 Unocal	14202.7	45.2	61.7	8003.0	26	7.8	1145.0	64
13	49 Anadarko Petroleum	19107.4	51.4	51.3	6067.0	18	11.0	1606.0	29
14	54 Marathon Oil	16400.7	38.4	90.2	45135.0	23	18.1	1257.0	24
15	86 Amerada Hess	9202.0	58.4	53.4	16733.0	17	9.2	970.0	108
16	129 Halliburton	19434.7	39.7	183.2	20466.0y	26	17.8	387.0	14
17	135 BJ Services	8116.1	15.8	51.2	2738.0	21	8.3	394.6	82
18	163 Baker Hughes	15914.4	27.1	39.4	6103.8	16	6.0	528.2	293
19	166 Schlumberger	44420.7	18.4	35.3	11480.2	15	-8.4	1014.1	155
20	168 Ashland	4706.4	39.0	63.9	8594.0	10	3.9	453.0	238
21	183 Kerr-McGee	11795.7	53.6	55.6	5178.7	24	13.4	404.0	59
22	208 Kinder Morgan	9916.1	34.8	110.5	1164.9y	6	3.8	528.5	38
23	249 Nabors Industries	8557.9	21.2	61.8	2394.0	27	5.1	302.5	57
24	315 Transocean	15588.0	64.5	73.2	2613.9	7	-3.1	152.2	727
25	362 Williams	10506.3	100.0	29.3	12461.3	-25	37.7	93.2	NM
26	377 Noble	7725.3	40.6	62.0	1066.2	8	1.8	146.1	-12
27	405 Rowan	3394.1	35.9	72.9	709.9	28	-1.9	27.2	NM
28	478 El Paso	7933.5	68.9	-64.9	6079.0ay	-2	-38.7	-398.0	NM

	NET MARGIN 2003	RETURN ON INVESTED CAPITAL	RETURN ON COMMON EQUITY	INVESTMENT DATA						ESTIMATED EARNINGS PER SHARE 2005
				RECENT SHARE PRICE \$	12-MONTH HIGH/LOW \$	P/E RATIO	DIVIDEND YIELD	EARNINGS PER SHARE 2004		
1	5.8	8.1	15.8	27	30/25	19	3.99	1.46	1.61	
3	3.9	3.7	11.1	21	29/18	17	0.75	1.26	1.32	
6	12.2	27.5	40.5	54	57/45	23	1.77	2.36	2.60	
8	12.4	20.5	34.2	53	57/51	21	1.88	2.51	2.63	
11	14.9	33.7	59.6	50	52/37	30	1.29	1.68	1.91	
9	9.7	46.6	89.0	43	47/35	24	1.54	1.77	1.99	
7	4.3	12.4	13.6	52	56/41	25	0.88	2.05	2.46	
7	11.7	17.7	26.7	66	69/59	19	2.73	3.55	3.82	
5	14.4	28.6	104.5	53	59/43	23	2.19	2.33	2.63	
6	11.8	33.0	NM	60	61/48	23	1.87	2.63	2.76	
3	6.8	11.0	20.8	60	61/37	15	1.13	3.86	4.19	
8	5.1	13.9	19.0	111	114/66	10	1.80	11.57	10.91	
1	6.6	23.1	28.8	62	63/42	10	2.58	6.14	5.13	
3	1.6	15.7	24.8	71	75/28	11	0.45	6.53	6.20	
9	17.3	18.3	24.7	70	72/43	11	1.77	6.59	6.50	
4	9.4	22.9	24.9	63	64/40	16	1.71	3.89	3.93	
5	26.1	15.4	20.3	63	64/39	12	0.51	5.04	5.66	
8	23.5	10.5	15.9	47	49/28	11	0.43	4.38	4.18	
7	2.0	19.8	38.0	99	101/58	12	1.21	8.21	7.45	
2	29.2	14.0	21.8	50	52/29	13	0.69	3.86	3.65	
5	25.1	15.6	20.8	46	47/22	18	0.35	2.58	2.81	
0	24.1	10.9	19.5	46	47/24	23	0.44	2.02	2.91	
3	11.0	14.7	21.9	54	55/34	13	1.48	4.25	4.26	
5	24.3	12.4	17.2	77	79/50	12	0.94	6.36	6.83	
8	2.8	8.8	16.3	47	48/30	13	2.37	3.72	4.02	
8	3.3	9.8	16.5	100	103/62	11	1.20	9.50	8.34	
9	2.1	5.1	9.8	44	45/26	50	1.14	0.88	1.91	
4	9.5	17.4	18.0	50	55/40	21	0.64	2.41	2.34	
7	2.6	10.6	13.6	47	48/33	30	0.97	1.57	1.91	
8	4.0	9.7	16.6	75	76/55	44	1.11	1.70	2.62	
3	1.7	11.5	15.9	65	66/44	10	1.69	6.28	5.37	
8	6.1	4.5	7.6	78	79/47	25	2.32	3.11	6.83	
4	34.8	8.1	18.4	80	81/57	19	3.49	4.23	4.22	
6	10.2	7.3	10.3	57	60/40	30	0.00	1.92	2.81	
8	0.8	1.5	2.1	48	50/24	103	0.00	0.47	1.45	
7	-0.3	0.7	2.3	19	19/9	105	1.06	0.18	0.83	
7	16.9	5.1	6.1	57	59/34	52	0.00	1.09	2.22	
8	-0.7	1.4	1.9	32	33/20	127	0.00	0.25	1.25	
5	-27.9	-1.9	-9.8	12	13/7	-18	1.30	-0.68	0.69	

An Edge From Razors

PROCTER & GAMBLE CO.

(No. 58) turned in another strong performance, boosting one-year profits by 20%, to \$6.9 billion. But after making the BusinessWeek 50 for two years in a row—ranking No. 26 in 2003—the maker of Pampers, Crest, and Tide slipped this year. The stock has returned just 5.6% over the past 12 months, well off a three-year return of 33.5%. Investors worry that P&G's growth pace will slow in the face of rising commodity prices and stepped-up investment by rivals. But with P&G's announced acquisition of razor maker Gillette Co., maybe those rivals are the ones who should worry.



TAKA

RANK		COMPANY	MARKET VALUE			SALES			PROFITABILITY	
INDUSTRY RANK	S&P 500 RANK		FEB. 28, 2005 \$ MIL.	TOTAL RETURN (1 YEAR)	TOTAL RETURN (3 YEAR)	12-MONTH 2004 \$ MIL.	CHANGE FROM 2003 %	3-YEAR AVERAGE CHANGE %	12-MONTH 2004 \$ MIL.	CHANGE FROM 2003 %
10 BANKS										
Industry Average			30017.7	4.1	41.6	9764.5	-15	1.8	2053.1	-3
1	50	Bank of America	188771.4	18.4	61.9	65447.0 _y	34	7.0	14143.0	31
2	88	Wachovia	84179.9	14.4	75.2	28067.0	14	7.4	5214.0	23
3	108	Countrywide Financial	20212.3	15.2	249.0	13995.6	4	14.6	2315.9	-2
4	159	Wells Fargo	100624.9	6.9	37.9	33876.0	7	6.4	7014.0	13
5	197	U.S. Bancorp	55264.3	8.0	61.2	14705.7	1	-3.3	4166.8	12
6	211	National City	23134.2	4.0	41.1	9769.7	2	3.1	2779.9	31
7	246	Golden West Financial	18970.8	7.7	96.6	4472.8 _y	16	0.4	1279.7	16
8	254	Regions Financial	15040.9	12.6	37.1	4610.0	27	3.4	823.8	26
9	261	North Fork Bancorporation	13622.6	5.5	36.5	1826.7 _y	44	12.5	553.0	40
10	272	BB&T	21548.4	9.2	17.1	6666.0	8	2.3	1558.4	46
11	279	M&T Bank	11408.7	4.8	35.2	3241.7	10	9.6	722.5	26
12	290	Marshall & Ilsley	9203.4	4.3	41.1	3112.3	13	4.6	627.1	15
13	323	Sovereign Bancorp	7915.6	4.1	84.3	2706.4 _y	10	0.9	453.6	13
14	327	PNC Financial Services Group	14897.1	-6.7	7.9	6315.0	6	-3.6	1197.0	16
15	341	Synovus Financial	8418.9	11.3	0.5	2680.0	10	5.4	437.0	12
16	344	SunTrust Banks	26139.3	3.2	25.7	7822.8	11	-2.7	1572.9	18
17	349	KeyCorp	13449.8	5.8	51.3	5564.0	-3	-8.6	954.0	6
18	378	Compass Bancshares	5597.4	12.3	66.3	1863.8	3	-0.6	369.8	8
19	382	Zions Bancorporation	5937.8	15.8	32.4	1923.0	2	-0.9	406.0	20
20	391	Washington Mutual	36684.0	-2.3	44.2	16199.0	-11	-2.6	2479.0	-35
21	398	MGIC Investment	6145.2	-4.8	-5.8	1612.7	-4	6.1	553.2	12
22	406	First Horizon National	5239.1	-4.6	35.7	2530.0	-7	2.4	454.4	-4
23	410	Comerica	9730.8	2.9	7.1	3094.0	-6	-9.7	757.0	15
24	413	AmSouth Bancorporation	8900.6	2.7	33.7	3031.7 _y	3	-3.4	623.5	0
25	415	Huntington Bancshares	5211.1	0.4	34.6	2165.9	-8	-3.9	398.9	3
26	418	Fifth Third Bancorp	24965.9	-18.0	-25.3	6579.0 _y	2	0.8	1525.0	-8
INC	INC	Freddie Mac	42691.6	2.0	2.5	NA	NA	NA	NA	NA
INC	INC	Fannie Mae	56589.3	-19.9	-19.8	NA	NA	NA	NA	NA

11 DIVERSIFIED FINANCIALS										
Industry Average			34761.4	2.2	46.5	16163.9	16	1.2	2258.7	6
1	71	Franklin Resources	17525.0	25.0	75.5	3622.1 _y	27	14.5	774.4	38
2	96	T. Rowe Price Group	7956.6	18.5	62.9	1280.3	28	7.6	337.3	48
3	114	Moody's	12412.6	26.0	129.4	1438.3	15	21.8	425.1	17
4	115	Capital One Financial	18924.6	8.6	56.6	10694.6	9	11.9	1543.5	34
5	116	Goldman Sachs Group	52328.3	3.8	38.0	29839.0	26	-0.9	4553.0	52
6	124	American Express	67633.4	2.2	52.4	29115.0 _y	13	5.2	3516.0	17
7	151	Lehman Brothers Holdings	24997.8	6.0	65.0	21250.0	23	-1.3	2369.0	39
8	181	SLM	20673.2	18.4	64.1	4368.5	0	5.3	1913.3	36
9	188	Merrill Lynch	54426.6	-3.2	27.2	32467.0	17	-5.2	4436.0	16
10	205	Bear Stearns	10326.8	14.4	86.3	8399.9	14	-0.3	1344.7	16
11	213	Provident Financial	5033.5	32.6	340.9	2659.9 _y	-4	-22.7	418.6	113

	NET MARGIN 2003	RETURN ON INVESTED CAPITAL	RETURN ON COMMON EQUITY	INVESTMENT DATA					
				RECENT SHARE PRICE \$	12-MONTH HIGH/LOW \$	P-E RATIO	DIVIDEND YIELD	EARNINGS PER SHARE 2004	ESTIMATED EARNINGS PER SHARE 2005
0	18.3	6.2	13.6	46	52/40	14	2.91	3.31	3.82
	22.1	7.1	14.2	47	47/39	13	3.86	3.69	4.05
	17.3	5.4	11.0	53	56/43	14	3.47	3.81	4.26
	17.6	3.9	22.2	35	40/27	9	1.61	3.83	3.89
	19.5	6.3	18.5	59	64/54	15	3.23	4.09	4.57
3	25.5	7.7	21.3	30	32/25	14	4.03	2.18	2.41
	22.1	6.4	21.7	36	40/33	8	3.91	4.31	3.07
	28.8	2.6	17.6	62	67/49	15	0.39	4.13	4.62
	18.0	4.6	7.7	32	36/27	15	4.22	2.19	2.49
3	31.3	5.3	6.2	29	31/23	16	3.05	1.85	2.36
4	17.2	7.0	14.3	39	43/33	14	3.58	2.80	3.11
3	19.4	6.0	12.6	99	109/83	17	1.62	6.00	6.68
	19.8	7.8	16.1	40	45/36	15	2.08	2.77	2.99
3	16.4	2.4	9.1	23	24/19	17	0.52	1.36	1.89
0	17.2	7.4	16.0	53	60/49	13	3.80	4.21	4.23
3	16.0	9.3	16.5	27	29/23	19	2.69	1.41	1.61
1	18.8	4.1	9.8	72	74/61	14	3.04	5.19	5.51
	15.8	4.3	13.4	33	35/28	14	3.94	2.30	2.57
3	19.0	6.0	18.1	45	49/38	15	3.08	2.95	3.23
1	18.0	8.1	14.6	66	70/54	15	2.18	4.47	4.98
3	20.9	2.3	11.7	42	45/37	15	4.39	2.81	3.51
3	29.3	11.6	13.4	63	79/60	11	0.48	5.63	6.10
0	17.4	10.2	22.2	43	49/41	12	4.04	3.54	3.55
5	20.0	8.1	14.8	57	64/50	13	3.85	4.36	4.49
6	21.3	5.5	17.5	25	27/22	14	4.00	1.74	2.00
4	16.3	4.5	15.7	23	25/21	13	3.56	1.71	1.79
2	25.5	6.7	17.1	45	58/44	17	3.13	2.68	3.22
A	14.7	NA	NA	62	74/56	NA	1.94	NA	6.79
A	12.1	NA	NA	58	79/56	NA	1.78	NA	7.10
0	15.3	10.9	13.4	49	54/39	15	1.39	3.29	3.52
4	19.6	11.6	14.5	70	71/47	23	0.57	3.03	3.72
3	22.8	19.9	19.9	61	63/44	24	1.50	2.51	3.02
6	29.2	94.9	288.2	84	89/62	30	0.52	2.79	3.22
4	11.8	6.2	18.4	77	85/61	12	0.14	6.21	6.92
3	12.7	4.2	18.2	109	114/83	12	0.92	8.92	8.77
1	11.6	7.2	22.0	54	58/47	20	0.89	2.74	3.11
1	9.8	3.5	15.4	91	95/67	12	0.88	7.90	7.78
8	32.0	2.4	61.3	49	55/36	12	1.56	4.04	2.52
7	13.8	3.2	14.6	59	65/47	13	1.09	4.38	4.82
0	15.6	3.3	14.6	100	110/75	10	1.01	9.76	8.96
7	7.1	10.7	15.1	17	18/12	13	0.00	1.30	1.40

They Paid A Pretty Penny

WACHOVIA CORP. (No. 88) burst into the BusinessWeek 50 two years ago on the strength of its merger with First Union Corp. Not only did First Union pay a scant 6% premium over the price Wachovia's shares were trading for but it also gained rights to the venerable Wachovia name. But Wachovia's latest merger—its June, 2004, deal for SouthTrust Corp.—didn't come nearly that cheap. To gain \$53 billion in assets, a leadership position in Alabama, and a toehold in the Texas market, Wachovia had to cough up a 20% premium for SouthTrust shares. That will be a drag on profits through 2006—one reason this bank has fallen on our list.



FIRST LIGHT/IMAGESTATE

RANK	COMPANY		MARKET VALUE			SALES			PROFITABILITY	
			FEB. 28, 2005 \$ MIL.	TOTAL RETURN 1 YEAR	TOTAL RETURN 3 YEAR	12-MONTH 2004 \$ MIL.	CHANGE FROM 2003 %	3 YEAR AVERAGE CHANGE %	3-MONTH 2005 \$ MIL.	CHANGE FROM 2004 %
12	223	MBNA	32414.6	-5.5	15.2	12327.0	6	7.2	2677.3	15
13	228	Citigroup	247654.9	-1.6	23.1	108276.0y	14	3.0	17046.0	-5
14	242	JPMorgan Chase	129979.1	-7.6	42.2	56931.0	28	3.8	4466.0	-34
15	256	Morgan Stanley	61387.8	-3.6	22.1	39549.0	13	-2.3	4509.0	18
16	281	Principal Financial Group	11729.4	9.4	66.1	8303.7	4	-2.0	702.5	9
17	305	Bank of New York	23538.2	-5.9	-13.1	7144.0y	13	0.8	1440.0	24
18	307	E*Trade Financial	4922.2	-7.3	63.8	2083.3	6	0.3	359.5	76
19	352	Mellon Financial	12141.8	-9.2	-15.2	4926.0	7	5.1	800.0	17
20	385	Federated Investors	3171.7	-7.0	-3.2	847.6	7	5.8	195.3	4
21	399	State Street	14630.3	-17.3	-10.2	5861.0y	15	1.2	798.0	11
22	400	Charles Schwab	14187.4	-13.5	-18.1	4202.0y	8	-7.7	414.0	-13
23	430	Northern Trust	9255.6	-13.4	-17.8	2829.1y	9	-4.8	504.8	19
24	443	CIT Group	8468.3	3.6	NA	4672.8	2	-3.9e	753.6	33
25	468	Janus Capital Group	3315.3	-17.8	-38.0	1010.8	2	-13.2	169.5	-82

12 INSURANCE

Industry Average			22191.4	3.6	19.2	17314.6	14	12.0	1631.9	35
1	21	Progressive	18900.7	5.5	68.5	13768.2	16	23.1	1648.7	31
2	40	Chubb	15244.5	13.9	12.7	12988.7y	15	19.4	1548.4	91
3	67	Allstate	36663.4	19.8	63.8	33936.0	6	5.9	3356.0	23
4	70	AFLAC	19401.0	-4.7	53.3	13275.0	16	11.4	1299.0	63
5	75	XL Capital	10396.7	0.4	-15.7	9904.5	26	33.7	1166.6	183
6	76	MetLife	30555.2	18.1	32.2	39014.0y	10	7.6	2708.0	43
7	82	Hartford Financial Services Group	21168.3	11.8	14.0	22693.0	21	14.4	2115.0	NM
8	117	Prudential Financial	29386.9	24.4	93.8	28348.0	2	2.0	2332.0	76
9	130	American International Group	174052.1	-9.4	-8.8	98610.0y	21	21.7	11229.3	21
10	145	ACE	12631.7	0.8	7.7	12330.0	15	25.9	1139.0	-20
11	161	Cincinnati Financial	7469.9	7.1	25.7	3614.0	14	12.1	584.0	56
12	165	Safeco	6056.6	7.9	48.9	6195.4	14	-5.5	620.2	117
13	221	Ambac Financial Group	8471.5	0.1	27.8	1403.1y	11	25.4	725.8	16
14	264	St. Paul Travelers	25685.9	-6.8	NA	22934.0	51	21.5	955.0	-44
15	295	Aon	7756.3	-4.2	-23.1	10172.0	5	10.0	685.0	1
16	309	Jefferson-Pilot	6684.1	-5.5	5.7	4102.1	15	7.0	562.7	14
17	332	Torchmark	5656.2	0.8	33.2	3071.5	5	4.5	475.7	11
18	359	Lincoln National	8177.4	4.1	1.4	5371.3	2	-3.7	731.5	-5
19	363	Loews	13228.5	19.4	26.5	14584.2y	-8	-6.9	1231.3	NM
20	389	MBIA	8401.2	-9.5	5.0	1982.2	7	22.8	801.5	-1
21	441	UnumProvident	5016.6	16.4	-36.1	10464.9	5	4.1	-192.2	NM
22	455	Marsh & McLennan	17206.6	-30.1	-33.2	12159.0	5	7.5	180.0	-88

13 REAL ESTATE

Industry Average			8533.7	21.5	60.1	1770.0	9	7.1	202.6	-13
1	171	Plum Creek Timber	6897.9	25.4	42.8	1528.0	28	33.2	339.0	77
2	300	Simon Property Group	13650.2	18.8	136.8	2722.9	13	8.7	343.5	2

INVESTMENT DATA									
	NET MARGIN 2003	RETURN ON INVESTED CAPITAL	RETURN ON COMMON EQUITY	RECENT SHARE PRICE \$	12-MONTH HIGH/LDW \$	P-E RATIO	DIVIDEND YIELD	EARNINGS PER SHARE 2004	ESTIMATED EARNINGS PER SHARE 2005
	20.0	10.9	21.3	25	30/22	12	2.21	2.05	2.25
	18.9	4.5	15.5	48	53/42	15	3.69	3.26	4.24
	15.1	2.1	4.2	37	44/35	24	3.72	1.55	3.05
	10.9	4.1	16.0	56	63/47	14	1.91	4.08	4.58
	8.1	8.4	9.3	39	42/32	17	1.41	2.23	2.69
	18.3	9.0	15.5	30	34/27	16	2.65	1.85	2.05
	10.4	2.5	16.1	13	15/10	14	0.00	0.94	1.01
	14.8	8.1	19.5	29	34/26	15	2.51	1.89	1.92
	23.6	25.7	41.2	30	34/27	17	1.69	1.77	1.88
	14.1	9.3	13.0	44	55/40	19	1.55	2.35	2.72
	12.2	8.0	9.1	11	12/8	35	0.76	0.30	0.53
	16.3	6.1	15.3	42	50/38	19	1.99	2.26	2.52
	12.4	1.9	12.4	40	47/33	12	1.29	3.50	3.88
	95.4	5.5	6.2	14	18/13	19	0.29	0.73	0.56
4	7.9	9.5	12.5	53	58/44	12	1.84	4.31	4.99
0	10.6	25.6	32.0	87	97/73	11	0.14	7.63	6.61
9	7.1	12.5	16.2	79	80/63	10	1.97	8.01	7.89
9	8.5	12.4	15.4	54	54/43	11	2.39	4.79	5.74
8	6.9	15.1	17.9	38	43/34	15	1.15	2.52	2.62
8	5.2	10.8	14.6	75	80/67	9	2.63	8.13	9.77
9	5.4	9.0	11.9	41	42/33	11	1.12	3.59	3.59
3	-0.5	11.4	14.9	72	74/53	10	1.61	7.12	7.43
2	4.7	8.0	10.8	57	60/40	17	1.10	3.45	4.39
4	11.4	6.8	13.5	67	77/54	16	0.75	4.26	5.24
2	13.3	9.4	11.1	44	48/32	12	1.89	3.83	5.77
2	11.8	8.3	9.3	45	46/38	13	2.73	3.44	3.12
0	5.2	11.8	15.8	48	53/41	10	1.85	4.59	4.97
7	49.7	12.5	14.4	78	85/64	12	0.64	6.54	6.88
2	11.2	3.5	4.6	38	43/30	25	2.30	1.53	4.50
7	7.0	10.0	13.9	25	29/18	12	2.45	2.04	1.74
7	13.8	11.9	14.7	49	56/46	12	3.41	4.04	4.02
5	14.7	11.6	13.9	52	58/49	12	0.84	4.26	4.59
6	14.5	9.6	12.2	47	50/41	11	3.12	4.19	4.18
4	-4.2	6.9	10.8	71	75/53	13	0.84	5.64	7.30
4	43.9	3.0	12.1	59	67/53	11	1.64	5.54	5.62
8	-2.6	-2.0	-2.8	17	18/11	-26	1.77	-0.65	1.76
5	13.3	1.8	3.6	33	49/23	96	4.17	0.34	2.04
4	14.4	2.2	3.6	39	42/29	51	4.87	0.77	0.95
2	16.1	8.3	15.1	38	39/27	20	4.05	1.84	1.58
6	14.0	1.5	6.5	62	66/44	43	4.52	1.44	1.53

It's All Just Ducky

AFLAC INC. (No. 70) looked like a lame duck after suffering heavy losses from its investment in Parmalat Finanziaria bonds back in 2003. But the Columbus (Ga.) supplemental accident and medical insurer regained some altitude last year. Profits rose 63%, to \$1.3 billion, thanks in part to strong sales from AFLAC's lucrative Japanese franchise, as well as favorable currency translations. Still, problems in its smaller U.S. business hammered AFLAC's stock. Daniel P. Amos is countering the U.S. slowdown by boosting training and recruiting and by rolling out new products.



AFLAC/AP/WIDE WORLD

RANK	COMPANY		MARKET VALUE			SALES			PROFITABILITY	
			FEB. 28, 2005 \$ MIL.	TOTAL RETURN (1 YEAR)	TOTAL RETURN (3 YEAR)	12 MONTH 2004 \$ MIL.	CHANGE FROM 2003 %	3-YEAR AVERAGE CHANGE %	12-MONTH 2004 \$ MIL.	CHANGE FROM 2003 %
3	330	Archstone-Smith Trust	6751.7	26.1	54.7	891.2	13	6.9	155.3	46
4	381	ProLogis	7294.7	24.9	104.5	601.1	2	2.9	233.5	-6
5	449	Equity Residential	9353.4	16.5	46.2	1892.9y	11	-2.9	135.3	-14
6	465	Equity Office Properties Trust	12162.6	12.3	29.1	3254.5	1	0.2	155.7	-70
7	470	Apartment Investment & Mgmt.	3625.6	26.6	6.5	1499.6	6	1.0	55.7	-13

14 HEALTH-CARE EQUIPMENT & SERVICES

Industry Average			14441.6	17.8	65.0	14239.5	16	14.0	534.7	16
1	5	UnitedHealth Group	58615.9	47.1	151.8	37218.0y	29	16.5	2587.0	42
2	22	Caremark Rx	17328.4	18.7	119.4	25801.1	185	62.6	600.3	106
3	30	Boston Scientific	27580.6	-20.0	192.1	5624.0	62	27.2	1062.0	125
4	35	WellPoint	16935.7	42.0	110.1	20815.1	24	26.0	960.1	24
5	38	Zimmer Holdings	21071.3	13.6	140.2	2980.9	57	36.5	541.8	86
6	53	Medtronic	63037.1	11.8	19.1	9942.0	16	17.4	2178.4	16
7	60	C.R. Bard	6960.7	42.1	153.5	1656.1	16	12.0	302.8	80
8	63	Aetna	21391.9	80.8	317.3	19904.1y	11	-7.7	1215.1	30
9	91	St. Jude Medical	13906.5	7.6	99.7	2294.2	19	19.6	409.9	22
10	109	Humana	5332.1	51.8	154.0	13104.3y	7	8.7	280.0	22
11	113	Express Scripts	5560.8	3.2	45.4	15114.7	14	16.5	278.2	11
12	121	Stryker	19963.3	12.1	62.4	4262.3	18	18.1	465.7	3
13	126	Fisher Scientific International	7093.6	13.9	109.1	4662.7	31	16.7	166.4	112
14	136	Cigna	12190.1	64.9	6.8	18176.0y	-3	-1.5	1577.0	170
15	157	Quest Diagnostics	9751.1	20.8	41.4	5126.6	8	12.5	499.2	14
16	158	Waters	5902.2	32.2	56.3	1104.5	15	8.6	224.1	31
17	160	Becton Dickinson	15142.0	24.6	69.2	5038.0	9	9.8	652.0	15
18	185	Biomet	10668.1	8.8	40.0	1752.2	18	16.1	318.1	3
19	202	Bausch & Lomb	3785.1	20.2	94.0	2232.3	11	10.3	159.6	26
20	204	Guidant	23535.6	8.4	79.1	3765.6	3	12.0	573.0	37
21	212	Health Management Associates	5604.4	3.6	31.6	3271.5	21	18.5	332.5	13
22	231	AmerisourceBergen	6354.5	3.4	-11.1	53462.9	6	28.3	430.8	-6
23	236	HCA	22795.8	12.5	17.9	23502.0	8	9.5	1246.0	-6
24	237	McKesson	11022.8	37.7	8.4	77842.7	17	17.5	-201.5	NM
25	243	Laboratory Corp. of America Hldgs.	6616.6	22.2	17.6	3084.8	5	12.4	363.0	13
26	257	Medco Health Solutions	12190.4	36.0	NA	35351.9	3	6.5	481.6	13
27	260	Cardinal Health	25352.2	-10.1	-10.9	69665.1	14	12.1	1249.1	-12
28	277	IMS Health	5578.6	-1.4	23.3	1569.0	14	6.3	285.4	105
29	285	Manor Care	2929.7	-2.1	87.1	3208.9	6	5.8	168.2	41
30	286	Thermo Electron	4387.1	-2.2	34.9	2206.0	16	-0.7	218.4	25
31	351	PerkinElmer	2841.1	7.9	3.1	1687.2	10	3.3	98.3	70
32	364	Hospira	4619.7	9.5c	NA	2645.0	10	0.8e	301.6	16
33	369	Millipore	2250.8	-13.5	-13.3	883.3	10	10.7	105.6	5
34	403	Baxter International	21962.2	24.5	-32.0	9509.0	7	7.7	383.0	-58
INC	INC	Tenet Healthcare	5197.5	-9.2	-71.7	9919.0	-2	NA	-1797.0	NM

			INVESTMENT DATA						
	NET MARGIN 2/03	RETURN ON INVESTED CAPITAL	RETURN ON COMMON EQUITY	RECENT SHARE PRICE \$	12-MONTH HIGH/LOW \$	P/E RATIO	DIVIDEND YIELD	EARNINGS PER SHARE 2004	ESTIMATED EARNINGS PER SHARE 2005
	13.4	1.7	3.5	34	39/26	46	5.11	0.73	1.86
	42.1	3.2	6.7	40	44/28	37	3.72	1.08	1.49
	9.2	0.7	1.6	33	37/27	89	5.27	0.37	0.44
	16.1	0.5	1.2	30	30/24	108	5.15	0.28	0.75
	4.5	-0.3	-1.1	38	39/26	-106	6.27	-0.36	-0.99
	3.8	12.4	13.3	55	59/40	23	0.39	2.37	2.91
	6.3	18.4	24.1	91	92/59	23	0.03	3.94	4.81
	3.2	7.4	8.0	38	42/28	27	0.00	1.43	1.91
	13.6	20.6	26.4	33	46/31	26	0.00	1.24	2.10
	4.6	4.1	4.9	122	125/72	20	0.00	6.10	7.79
	15.3	11.8	13.7	86	89/64	39	0.00	2.19	2.91
	21.9	17.8	21.3	52	55/44	29	0.64	1.79	2.18
	11.8	19.8	22.3	67	71/46	24	0.72	2.82	2.83
	5.2	11.4	13.4	146	147/77	19	0.03	7.74	8.95
	17.4	16.0	17.6	39	43/31	36	0.00	1.10	1.40
	1.9	10.3	13.4	33	36/15	19	0.00	1.72	2.12
	1.9	17.3	23.3	75	81/58	21	0.00	3.59	4.57
	12.5	16.9	16.9	50	58/40	44	0.18	1.14	1.74
	2.2	2.7	4.3	61	65/51	34	0.00	1.80	3.58
	3.1	26.1	30.3	91	91/54	8	0.11	11.44	6.15
	9.2	16.6	21.8	99	101/79	21	0.72	4.69	5.50
	17.8	30.1	32.8	49	52/36	27	0.00	1.82	2.15
	12.3	14.8	19.5	60	60/46	24	1.20	2.48	2.86
	20.8	21.5	21.5	42	50/37	34	0.47	1.24	1.82
	6.3	8.0	11.2	71	75/57	24	0.74	2.93	3.42
	11.5	14.0	15.3	73	74/50	41	0.55	1.78	2.62
	10.9	11.0	16.1	23	24/19	17	0.70	1.35	1.48
	0.9	8.1	10.2	60	64/50	16	0.17	3.79	3.79
	6.1	8.2	28.3	47	47/35	18	1.27	2.58	2.84
	0.9	-3.3	-4.1	37	38/23	-54	0.64	-0.69	2.31
	10.9	12.7	18.2	48	51/37	20	0.00	2.45	2.77
	1.2	7.1	8.4	44	45/29	25	0.00	1.75	2.38
	2.3	11.4	14.6	59	77/36	20	0.21	2.87	3.23
	10.1	41.3	144.6	24	26/20	20	0.33	1.20	1.32
	3.9	10.9	17.1	34	37/29	18	1.76	1.90	2.12
	9.2	7.6	8.2	27	31/24	21	0.00	1.31	1.46
	3.8	5.4	6.7	22	24/15	29	1.26	0.76	1.11
	10.8	17.9	30.6	30	35/24	15	NA	1.92	1.60
	12.6	13.4	16.5	45	57/42	22	0.00	2.10	2.42
	10.2	5.1	10.7	36	37/28	58	1.63	0.62	1.86
	-10.3	-29.3	-103.8	11	13/9	-3	0.00	-3.85	-0.08

Gizmos In the Body

Some of the most important medical breakthroughs are coming not from new drugs but from tiny devices, such as the heart valve below, that go right into the patient.

ST. JUDE MEDICAL INC.

(No. 91) scored a big hit last year with an implantable defibrillator. Sales of those devices jumped 41% last year. That contributed to a 22% growth in profits, to \$409.9 million, and a 19% sales gain, to \$2.3 billion. So what knocked St. Jude off its BusinessWeek 50 perch? Investors found greener pastures in energy and industrials; St. Jude's 7.6% returns through Feb. 28 were way off its sizzling pace over the past three years, when it returned 99.7%.



RANK		COMPANY	MARKET VALUE			SALES			PROFITABILITY	
INDUSTRY RANK	S&P RANK		FEB. 28, 2005 \$ MIL.	TOTAL RETURN (1 YEAR)	TOTAL RETURN (3 YEAR)	12-MONTH 2004 \$ MIL.	CHANGE FROM 2003 %	3 YEAR AVERAGE CHANGE %	12-MONTH 2004 \$ MIL.	CHANGE FROM 2003 %
15 PHARMACEUTICALS & BIOTECHNOLOGY										
Industry Average			44980.5	-11.6	-8.6	11577.8	12	20.6	1913.3	33
1	26	Johnson & Johnson	194728.4	24.0	13.5	47348.0	13	13.8	8509.0	18
2	47	Gilead Sciences	14934.4	27.3	96.1	1324.6	53	79.0	449.4	NM
3	78	Pfizer	197989.8	-26.6	-31.9	52516.0	17	23.6	11332.0	596
4	90	Abbott Laboratories	71624.5	17.7	-6.8	19680.0	14	5.6	3175.8	27
5	102	Forest Laboratories	15155.7	-43.4	7.4	3159.2	24	29.2	931.5	21
6	106	Amgen	77628.6	-3.0	6.3	10550.0	26	39.3	2363.0	5
7	191	Genzyme General	12870.9	11.2	26.4	2201.1	40	32.3	146.7	56
8	217	Allergan	9869.6	-13.7	22.5	2045.6	15	19.9	377.1	NM
9	326	Merck	70277.3	-31.4	-40.0	22938.6	2	-19.3	5813.4	-12
10	333	Eli Lilly	63371.8	-22.4	-21.1	13857.9	10	7.0	1810.1	-29
11	346	Bristol-Myers Squibb	48698.6	-5.7	-39.1	19380.0	4	2.4	2378.0	-23
12	367	Wyeth	54456.1	5.9	-31.2	17358.0	10	7.6	1234.0	-40
13	402	Biogen Idec	12891.8	-30.3	-38.5	2209.7	225	97.3	44.8	NM
14	411	Watson Pharmaceuticals	3475.0	-30.9	8.4	1640.6	13	12.9	151.3	-25
15	423	Applied Biosystems Group	4032.6	-9.1	-6.8	1753.7	4	2.5	196.3	-12
16	461	Mylan Laboratories	4738.6	-24.6	32.4	1270.3	-9	6.9	240.3	-28
17	469	Schering-Plough	27932.3	6.8	-41.2	8272.0	-1	-6.7	-947.0	NM
18	472	Chiron	6642.8	-27.3	-18.1	1607.6	-3	17.4	60.0	-73
19	480	King Pharmaceuticals	2307.7	-50.4	-69.3	1301.9a	-7	18.7	3.3	-91
20	484	MedImmune	5983.9	-6.3	-41.6	1141.1	8	22.7	-3.8	NM

16 CAPITAL GOODS										
Industry Average			27677.9	22.2	52.0	18340.8	15	9.4	1326.1	29
1	16	Paccar	13072.7	40.9	159.0	11396.3	39	22.2	906.8	72
2	23	Caterpillar	32434.5	28.0	84.0	30251.0	33	13.8	2035.0	85
3	29	Cummins	3215.4	51.2	92.2	8438.0	34	13.4	350.0	548
4	36	Deere	17554.2	12.5	56.4	20629.4 ^y	27	16.1	1458.1	95
5	43	Danaher	16734.2	21.0	61.8	6889.3	30	21.5	746.0	39
6	51	Eaton	10595.0	21.3	83.8	9817.0	22	10.5	648.0	68
7	52	3M	64929.1	9.6	50.6	20011.0	10	8.0	2990.0	24
8	68	Rockwell Automation	11448.0	107.2	237.5	4605.7	14	3.7	419.1	41
9	73	United Technologies	51048.5	10.2	43.5	37445.0 ^y	21	10.3	2788.0	18
10	81	Lockheed Martin	25938.4	30.1	9.2	35526.0	12	14.5	1266.0	20
11	85	Illinois Tool Works	26538.2	14.2	26.9	11731.4	17	7.9	1339.6	29
12	92	Rockwell Collins	8201.5	43.2	106.5	3065.0	17	3.3	323.0	17
13	93	L-3 Communications Holdings	7729.9	35.6	32.3	6897.0	36	41.4	381.9	38
14	97	Masco	15147.7	22.8	28.8	12074.0	14	13.6	930.0	18
15	101	Ingersoll-Rand	14509.1	28.4	75.7	9393.6	14	-1.6	829.8	56
16	105	Parker Hannifin	7907.3	18.6	38.1	7761.8	20	8.6	477.7	132
17	118	General Dynamics	21178.8	16.0	21.4	19178.0	17	16.6	1203.0	23
18	123	Northrop Grumman	18801.3	6.5	3.9	29853.0	13	33.9	1116.0	47

			INVESTMENT DATA						
	NET MARGIN 2003	RETURN ON INVESTED CAPITAL	RETURN ON COMMON EQUITY	RECENT SHARE PRICE \$	12-MONTH HIGH/LOW \$	P/E RATIO	DIVIDEND YIELD	EARNINGS PER SHARE 2004	ESTIMATED EARNINGS PER SHARE 2005
	14.0	11.3	17.4	38	49/32	31	1.22	1.22	1.87
	17.2	24.7	27.0	66	67/49	23	1.74	2.84	3.40
	-8.3	25.8	24.0	35	39/26	35	0.00	0.99	1.26
	3.6	14.8	16.6	26	38/22	17	2.89	1.51	2.12
	14.5	18.0	24.5	46	48/38	23	2.39	2.02	2.49
	30.3	27.4	27.4	43	79/36	17	0.00	2.47	2.61
	27.0	10.8	12.0	62	65/52	34	0.00	1.81	2.82
	6.0	3.5	3.3	56	61/41	89	0.00	0.63	2.13
	-3.0	22.4	33.8	75	93/67	27	0.53	2.82	3.14
	29.3	22.7	33.6	32	49/26	12	4.80	2.61	2.47
	20.4	11.7	16.6	56	77/50	34	2.71	1.66	2.91
	16.6	12.4	22.3	25	28/22	21	4.48	1.21	1.40
	12.9	6.5	11.1	41	45/34	45	2.25	0.91	2.75
	-128.8	0.6	0.7	39	70/36	297	0.00	0.13	1.68
	13.9	5.3	6.7	32	48/25	25	0.00	1.27	1.40
	13.2	13.9	13.9	21	23/18	21	0.83	0.98	0.99
	23.9	13.2	13.2	18	25/14	20	0.68	0.87	0.84
	-1.1	-9.2	-11.9	19	22/15	-28	1.16	-0.67	0.21
	13.3	1.6	2.3	36	50/29	111	0.00	0.33	1.42
	2.6	0.1	0.2	10	20/9	955	0.00	0.01	1.03
	17.4	-0.2	-0.2	24	29/22	-1204	0.00	-0.02	0.37
	6.4	10.6	15.2	59	63/45	19	1.47	3.08	3.71
	6.4	16.3	24.1	75	81/50	15	1.06	5.16	6.54
	4.8	8.4	27.3	95	99/69	17	1.73	5.75	7.29
	0.9	12.0	25.0	73	85/49	10	1.64	7.39	8.42
	4.6	8.5	22.4	71	75/57	12	1.74	5.77	5.97
	10.1	13.5	16.1	54	59/44	24	0.11	2.30	2.70
	4.8	12.1	18.0	70	73/53	17	1.78	4.13	5.27
	13.2	26.2	28.8	84	90/73	22	2.00	3.75	4.22
	7.4	15.4	21.4	62	63/28	28	1.06	2.21	2.65
	7.6	14.6	19.9	100	106/81	18	1.76	5.52	6.03
	3.3	10.4	18.0	59	62/43	21	1.69	2.83	3.34
	10.4	15.7	17.6	90	97/73	20	1.25	4.39	5.09
	10.6	22.5	26.1	46	47/29	26	1.04	1.79	2.11
	5.5	7.0	11.9	72	77/52	22	0.69	3.33	4.03
	7.5	9.8	17.7	34	38/26	17	2.14	2.04	2.52
	6.5	11.9	14.5	84	85/59	18	1.12	4.73	5.75
	3.2	10.9	14.1	66	78/52	17	1.22	3.98	4.61
	6.0	11.9	17.8	105	110/85	18	1.37	5.97	6.78
	2.9	5.2	6.7	53	58/48	17	1.74	3.06	3.53

An Rx For Slow Growth?

To succeed in the drug industry, you need blockbusters. **AMGEN INC.** (No. 106) has a couple, which explains why sales shot up 26% last year. So how come its stock sank 3% through Feb. 28? Because investors fear that Amgen can't keep it up. New Medicare reimbursement regulations mean that doctors might be less inclined to prescribe pricey treatments such as Aranesp, an anemia drug that costs \$846 a dose. Or physicians may not use the drugs at all, if they decide a condition isn't serious enough to worry about. Amgen executives have been working closely with doctors to help manage the Medicare changes. But growth is certain to slow down, and uncertainty is sending a chill through this former highflier.

MICHAEL FREEMAN/PHOTOTAKE

RANK	COMPANY		MARKET VALUE			SALES			PROFITABILITY	
			FEB. 28, 2005 \$ MIL	TOTAL RETURN (YEAR)	TOTAL RETURN 3 YEAR	12-MONTH 2004 \$ MIL	CHANGE FROM 2003 %	3-YEAR AVERAGE CHANGE %	12-MONTH 2004 \$ MIL	CHANGE FROM 2003 %
19	147	ITT Industries	8115.9	17.5	53.3	6764.1	21	13.0	437.5	11
20	180	Tyco International	67379.5	17.7	16.2	40553.0	10	5.2	3025.0	153
21	195	Emerson Electric	27826.9	8.9	25.2	15985.0	12	2.7	1310.0	26
22	214	Dover	7864.0	0.3	2.8	5488.1	24	7.7	409.1	43
23	220	Raytheon	17288.3	28.7	6.4	20245.0	12	8.1	439.0	-18
24	227	General Electric	372139.1	10.9	-1.1	151300.0	13	5.9	16593.0	6
25	233	Boeing	43602.3	28.8	26.3	52457.0	4	-3.8	1820.0	166
26	234	American Standard	9844.6	26.5	111.1	9508.8	11	8.5	313.4	-23
27	244	Cooper Industries	6419.8	34.1	114.5	4462.9	10	2.0	339.8	24
28	258	W.W. Grainger	5687.7	34.7	10.7	5049.8	8	1.9	286.9	26
29	266	Fluor	5256.1	54.3	74.4	9380.3	7	0.1	186.3	4
30	269	American Power Conversion	4230.0	-0.7	73.6	1699.9	16	7.2	181.5	3
31	288	Textron	10471.1	42.8	77.3	10242.0	5	-5.9	373.0	28
32	298	Pall	3356.7	5.0	45.8	1852.6	9	15.3	155.8	8
33	314	Honeywell International	32275.0	10.7	7.2	25601.0	11	2.8	1281.0	-5
34	319	Goodrich	4411.9	28.8	42.1	4724.5	8	5.2	156.0	305
35	340	Navistar International	2762.2	-15.3	-7.2	9713.0	28	13.0	247.0	NM
36	485	Power-One	488.5	-52.5	-17.2	280.3	9	-6.5	-21.2	NM

17 COMMERCIAL SERVICES & SUPPLIES

Industry Average			9050.1	6.6	19.6	5751.4	14	8.7	453.8	20
1	100	Cendant	23288.8	8.7	42.2	19785.0	10	31.4	1820.0	27
2	174	Apollo Group	13282.8	-3.4	127.5	1921.5	33	32.7	303.0	10
3	175	R.R. Donnelley	7385.9	8.0	30.0	7156.4	71	8.0	264.9	38
4	178	Robert Half International	5045.9	31.0	13.2	2675.7	35	3.0	140.6	2100
5	275	Waste Management	16673.0	5.3	14.9	12516.0	7	3.5	931.0	29
6	302	Equifax	3932.5	16.5	2.4	1272.8	5	4.3	237.3	31
7	308	Monster Worldwide	3424.6	31.1	7.5	845.5	30	-15.5	74.3	1013
8	313	H&R Block	8798.8	0.3	11.0	4245.8	8	10.4	571.0	-8
9	317	Avery Dennison	6066.7	-1.2	2.6	5340.9	12	12.2	279.7	15
10	339	Pitney Bowes	10576.2	14.0	20.4	4957.4	8	6.1	480.5	-3
11	342	Cintas	7516.6	3.3	1.1	2937.9	8	9.7	285.4	11
12	489	Allied Waste Industries	2609.9	-34.9	-37.0	5362.0	2	-1.0	58.0	-48

18 TRANSPORTATION

Industry Average			21010.0	20.0	23.4	14352.1	11	4.2	300.3	-53
1	39	FedEx	29462.9	42.8	70.6	27412.0	19	10.4	1303.0	102
2	103	United Parcel Service	86866.3	11.4	37.2	36582.0	9	6.5	3333.0	15
3	107	Norfolk Southern	14212.7	64.0	57.2	7312.0	13	5.6	923.0	125
4	200	Burlington Northern Santa Fe	18942.3	58.9	82.7	10946.0	16	5.9	791.0	2
5	259	Ryder System	2730.6	16.9	60.0	5150.3	7	0.9	215.6	59
6	324	CSX	8881.7	32.5	13.6	8020.0	8	-1.2	418.0	205
7	419	Union Pacific	16530.0	1.7	9.9	12215.0	6	1.0	604.0	-43
8	420	Southwest Airlines	10872.0	0.4	-34.2	6530.0	10	5.8	313.0	-29
9	479	Delta Air Lines	591.6	-48.3	-86.4	15002.0	6	2.9	-5198.0	NM

INVESTMENT DATA

NET MARGIN 2003	RETURN ON INVESTED CAPITAL	RETURN ON COMMON EQUITY	RECENT SHARE PRICE \$	12-MONTH HIGH/LOW \$	P-E RATIO	DIVIDEND YIELD	EARNINGS PER SHARE 2004	ESTIMATED EARNINGS PER SHARE 2005
7.0	15.2	18.7	88	90/71	19	0.82	4.63	5.14
3.2	6.5	9.4	33	37/27	24	1.20	1.42	1.97
7.3	12.3	17.1	66	71/56	21	2.50	3.10	3.45
6.5	10.6	13.1	39	43/35	19	1.66	2.00	2.31
3.0	2.9	4.2	38	42/29	39	2.09	0.99	1.89
11.7	3.4	15.0	35	38/29	22	2.50	1.59	1.81
1.4	8.2	16.1	55	55/38	25	1.82	2.24	2.56
4.7	13.3	33.7	46	47/34	32	1.31	1.42	2.66
6.8	11.4	14.9	69	71/51	19	2.05	3.58	4.10
4.9	13.9	13.9	63	67/45	20	1.27	3.13	3.42
2.0	11.1	14.1	63	64/36	28	1.02	2.28	2.53
12.1	12.1	12.1	22	25/15	24	1.82	0.90	0.90
3.0	4.8	10.2	77	79/51	29	1.81	2.66	4.03
8.5	9.2	13.6	27	30/22	22	1.48	1.24	1.45
5.8	8.4	11.4	38	40/31	25	2.17	1.49	2.00
0.9	4.8	11.6	37	37/27	28	2.16	1.30	1.79
-0.2	9.6	46.5	39	50/33	12	0.00	3.20	4.77
-7.1	-7.8	-7.8	6	14/6	-23	0.00	-0.25	-0.14
7.5	13.9	15.7	38	43/32	25	1.37	1.54	1.96
7.9	6.7	14.3	22	25/20	13	1.63	1.71	1.40
19.0	39.4	39.4	74	98/63	82	0.00	0.90	2.43
4.6	4.8	6.7	33	35/28	26	3.13	1.30	1.96
0.3	15.4	15.4	29	31/21	37	0.96	0.79	1.16
6.2	6.5	15.6	29	31/26	18	2.74	1.60	1.58
14.9	25.7	45.3	30	31/23	17	0.40	1.78	1.73
1.0	10.8	9.8	29	34/18	47	0.00	0.62	0.87
15.8	24.0	39.4	53	56/44	17	1.65	3.20	3.99
5.1	10.9	18.1	61	67/54	22	2.50	2.78	3.30
10.8	10.7	37.2	46	48/41	22	2.70	2.05	2.65
9.5	11.3	13.9	44	48/40	26	0.73	1.66	2.02
2.1	0.4	1.4	8	14/8	75	0.00	0.11	0.43
4.9	0.0	4.1	47	52/35	NM	1.01	-2.40	1.80
2.8	11.3	14.8	98	101/66	23	0.29	4.27	5.45
8.7	17.9	21.5	77	89/68	26	1.70	2.93	3.32
6.4	6.2	11.6	36	37/20	16	1.23	2.31	2.52
8.3	5.1	8.5	50	51/30	24	1.35	2.10	3.41
2.8	7.4	14.3	42	56/35	13	1.51	3.28	3.27
1.8	3.2	6.1	41	42/29	22	0.97	1.87	2.61
9.1	2.9	4.8	63	68/55	28	1.89	2.30	3.14
7.4	4.3	5.7	14	17/13	36	0.13	0.38	0.51
-5.5	-58.5	NM	5	9/3	0	0.00	-41.07	-8.01

Back on A Buying Spree

Henry R. Silverman is returning to his roots: real estate and travel. The chief executive of **CENDANT CORP.** (No. 100) has been shedding unrelated units, including an initial public offering of Jackson Hewitt Tax Service Inc. He has also been buying up travel services such as Orbitz Inc. With real estate and car operations hot, Cendant's net income rose 27% in the past year, to \$1.8 billion. But the company fell from No. 2 in 2004, partly because investors got skittish about the impact of rising rates on real estate. Also, the fact that Cendant was out buying again after its notorious stumble in acquiring scandal-ridden CUC International gave the market some pause.



JON FEINGERSH/CORBIS

RANK		COMPANY	MARKET VALUE			SALES			PROFITABILITY	
INDUSTRY RANK	S&P 500 RANK		FEB. 28 2005 \$ MIL.	TOTAL RETURN (1 YEAR)	TOTAL RETURN (3 YEAR)	12-MONTH 2004 \$ MIL.	CHANGE FROM 2003 %	3-YEAR AVERAGE CHANGE %	2004 EPS \$ MIL.	PERF. RANK '03
19 SOFTWARE & SERVICES										
Industry Average			21988.6	4.2	22.6	5430.9	11	10.7	797.5	35
1	8	Yahoo!	42993.7	45.6	346.3	3564.5	119	70.6	839.6	253
2	25	Autodesk	6820.7	107.2	174.0	1233.8	30	9.8	221.5	84
3	28	Adobe Systems	14955.0	65.9	70.5	1666.6	29	10.7	450.4	69
4	32	Symantec	15579.8	7.5	144.1	2426.6	42	33.3	533.4	66
5	34	Electronic Arts	19795.8	36.7	139.7	3173.7	12	25.3	586.6	18
6	42	Microsoft	273740.8	6.4	-2.3	38474.0	12	12.6	9996.0	28
7	99	First Data	34038.4	0.3	1.2	10013.2	19	14.3	1867.8	34
8	187	Oracle	66096.8	0.6	-22.1	10556.0	9	0.3	2949.0	19
9	193	Flserv	7369.8	-1.6	-11.2	3729.7	27	19.2	394.9	28
10	218	Mercury Interactive	3873.3	-5.5	35.4	685.5	35	24.1	84.6	104
11	230	SunGard Data Systems	7542.4	-10.2	-15.4	3555.9	20	20.7	453.6	23
12	241	Computer Sciences	8830.8	10.6	-2.7	14261.2	10	8.9	531.4	13
13	252	Citrix Systems	3781.5	5.9	48.3	741.2	26	8.2	131.5	4
14	255	Paychex	12080.3	1.2	-9.7	1365.3	14	14.3	316.5	4
15	278	Veritas Software	10224.0	-20.7	-31.8	2041.9	17	11.5	411.4	16
16	287	Automatic Data Processing	25049.8	2.6	-15.3	8055.5	9	5.0	970.4	0
17	294	Affiliated Computer Services	6548.8	7.1	5.7	4145.3	3	18.4	380.3	-24
18	304	Intuit	8022.1	-3.6	13.0	1917.5	9	15.9	328.3	12
19	390	Novell	1980.1	-48.5	28.1	1188.9	7	2.8	442.2	NM
20	396	Parametric Technology	1566.1	27.0	-21.3	672.4	2	-9.1	80.5	NM
21	424	Sabre Holdings	2855.9	-5.8	-50.8	2131.0	4	0.4	190.4	129
22	434	Computer Associates Intl.	16019.9	2.3	68.3	3476.0	9	5.9	24.0	NM
23	448	Electronic Data Systems	10930.3	13.1	-61.3	20623.0	0	-1.7	-295.0	NM
24	453	Compuware	2618.4	-13.8	-40.8	1250.8	-1	-12.2	83.7	124
25	458	BMC Software	3311.9	-23.7	-6.9	1468.1	5	2.8	96.7	NM
26	460	Convergys	2122.6	-7.8	-50.8	2487.7	9	2.1	111.5	-35
27	482	Unisys	2591.2	-45.6	-30.8	5820.7	-2	-0.5	38.6	-85
28	494	Siebel Systems	4341.4	-34.4	-69.3	1339.8	-1	-14.1	110.7	NM

20 SEMICONDUCTORS & SEMICONDUCTOR EQUIPMENT

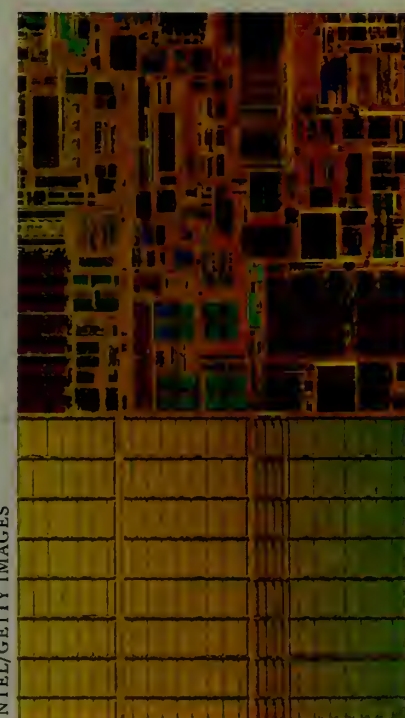
Industry Average			17420.9	-15.1	-16.0	4594.6	24	9.1	728.8	189
1	55	Intel	150009.5	-17.2	-14.6	34209.0	13	9.2	7516.0	33
2	131	Applied Materials	29320.6	-17.9	-19.7	8238.2	65	9.8	1557.7	NM
3	139	Texas Instruments	45478.5	-13.3	-8.7	12580.0	28	15.5	1861.0	55
4	146	Maxim Integrated Products	14055.3	-13.1	-4.6	1662.1	35	11.3	523.0	51
5	149	Altera	7721.4	-6.2	8.8	1016.4	23	7.5	275.1	77
6	155	National Semiconductor	7088.3	1.5	58.8	2081.7	20	9.2	395.0	598
7	172	Analog Devices	13678.7	-26.0	-0.5	2609.0	19	12.3	561.3	58
8	177	Linear Technology	12041.1	-1.5	8.5	950.3	40	10.7	390.7	44
9	189	Xilinx	10525.1	-27.6	-15.4	1585.6	22	11.8	376.4	70
10	283	KLA-Tencor	9711.4	-6.3	-14.7	1891.8	49	-4.7	400.8	190
11	311	Broadcom	10642.5	-20.2	5.2	2400.6	49	36.9	218.7	NM

RANK 2004	NET MARGIN 2003	RETURN ON INVESTED CAPITAL	RETURN ON COMMON EQUITY	INVESTMENT DATA					
				RECENT SHARE PRICE \$	12-MONTH HIGH/LOW \$	P/E RATIO	DIVIDEND YIELD	EARNINGS PER SHARE 2004	ESTIMATED EARNINGS PER SHARE 2005
7	12.1	14.1	16.6	28	34/22	27	0.29	1.05	1.28
6	14.6	10.6	11.8	32	40/21	56	0.00	0.58	0.52
0	12.6	34.2	34.2	30	39/14	33	0.20	0.90	1.09
0	20.6	31.6	31.6	62	65/34	34	0.08	1.82	2.02
0	18.9	14.8	14.8	22	34/20	29	0.00	0.75	1.03
5	17.6	17.6	17.6	64	70/43	35	0.00	1.86	2.03
0	22.7	21.2	21.2	25	30/24	27	1.27	0.92	1.28
7	16.6	13.8	19.6	41	47/39	18	0.59	2.22	2.37
9	25.6	33.7	34.3	13	15/10	23	0.00	0.56	0.75
6	10.6	13.1	15.4	38	41/32	19	0.00	2.00	2.20
3	8.2	6.1	14.6	46	51/31	55	0.00	0.83	1.54
8	12.5	12.1	14.0	26	29/22	17	0.00	1.54	1.55
7	3.6	6.6	8.6	46	58/38	17	0.00	2.79	3.28
7	21.6	14.2	14.2	23	26/15	30	0.00	0.75	1.02
2	25.3	24.5	24.5	32	39/29	38	1.63	0.83	1.09
1	20.2	9.3	10.5	24	32/16	26	0.00	0.94	1.06
0	13.2	16.9	17.2	43	47/39	26	1.44	1.64	1.78
2	12.5	12.4	13.5	52	61/46	18	0.00	2.85	3.12
1	16.8	19.1	19.1	43	47/36	26	0.00	1.67	1.99
2	-12.6	20.6	29.5	5	13/5	6	0.00	0.95	0.13
0	-17.3	29.9	29.9	6	6/4	19	0.00	0.30	0.29
9	4.1	8.4	11.4	21	29/20	15	1.71	1.38	1.53
7	-5.3	0.3	0.5	27	32/22	677	0.30	0.04	0.99
4	-1.7	-2.8	-3.9	21	23/16	-36	0.94	-0.59	0.57
7	2.9	5.6	5.6	7	9/4	31	0.00	0.22	0.34
6	-3.1	7.8	7.8	15	21/14	35	0.00	0.43	0.84
5	7.5	7.0	8.7	15	17/12	19	0.00	0.77	0.99
7	4.4	1.6	2.6	8	15/7	70	0.00	0.11	0.13
3	-0.4	5.1	4.9	9	13/7	43	0.00	0.20	0.29
59	6.8	10.4	14.6	24	31/18	31	0.32	0.78	0.86
20	18.7	19.1	19.5	24	30/20	21	1.33	1.16	1.24
89	0.0	16.0	16.8	17	23/15	19	0.00	0.90	0.72
48	12.2	13.9	14.2	26	32/18	25	0.38	1.05	1.13
15	28.1	21.9	21.9	43	53/38	28	0.93	1.51	1.61
71	18.8	21.5	21.5	21	26/18	29	0.00	0.72	0.60
90	3.3	21.0	21.3	20	24/12	19	0.40	1.03	0.88
15	16.3	15.0	15.0	37	52/31	26	0.65	1.44	1.28
11	39.8	20.3	20.3	39	41/34	31	1.02	1.25	1.31
37	17.0	14.4	14.4	30	44/25	29	0.66	1.04	0.92
12	10.9	14.1	14.1	49	55/35	25	0.97	2.00	2.27
91	-59.6	9.2	9.2	32	47/25	51	0.00	0.63	1.04

A Chip Star Struggles

When the BusinessWeek 50 first appeared, in 1997, heading the list was hotshot **INTEL CORP.** (No. 55).

That was no surprise: PC sales were surging, and Intel had a lock on the brains inside. Today, though, the picture is far different. The chipmaking king has struggled with factory snafus and execution missteps. Those woes were reflected in Intel's stock returns, of -17.2% for the 12 months ended Feb. 28. But its execs have been taking action—reorganizing divisions and rolling out new chips. Profits rose 33% last year, to \$7.5 billion, on 13% higher sales, of \$34.2 billion. And first-quarter results should show further improvement.



INTEL/GETTY IMAGES

RANK	COMPANY		MARKET VALUE			SALES			PROFITABILITY	
			FEB. 28, 2005 \$ MIL.	TOTAL RETURN (1 YEAR)	TOTAL RETURN (3 YEAR)	12-MONTH 2004 \$ MIL.	CHANGE FROM 2003 %	3-YEAR AVERAGE CHANGE %	12-MONTH 2004 \$ MIL.	CHANGE FROM 2003 %
12	345	NVIDIA	4818.5	30.3	-43.2	2010.0	10	11.9	100.4	35
13	354	Advanced Micro Devices	6209.4	16.3	29.3	5001.4	42	10.7	91.2	NM
14	379	Micron Technology	7046.0	-23.5	-64.2	4557.3	30	18.3	311.0	NM
15	386	Novellus Systems	4128.7	-8.1	-30.7	1357.3	47	1.4	156.7	NM
16	407	Freescale Semiconductor	7672.0	2.6d	NA	5715.0	17	6.9e	211.0	NM
17	412	Teradyne	2993.9	-37.4	-54.0	1791.9	32	7.9	165.2	NM
18	427	PMC-Sierra	1759.6	-50.0	-31.9	297.4	19	-1.1	51.7	NM
19	476	Applied Micro Circuits	1062.0	-46.7	-55.1	236.9	128	-1.6	-124.2	NM
20	495	LSI Logic	2455.8	-36.8	-57.4	1700.2	0	-2.1	-463.5	NM

21 TECHNOLOGY HARDWARE & EQUIPMENT

Industry Average			23255.0	-1.5	29.7	13041.9	14	1.2	852.3	99
1	13	Qualcomm	59230.1	15.1	119.9	5065.0	27	22.4	1827.0	57
2	14	Apple Computer	36296.1	275.1	313.5	9763.0	45	19.0	508.0	271
3	15	Dell	99503.4	22.8	62.4	49205.0	19	16.5	3043.0	15
4	46	Cisco Systems	112899.0	-24.8	22.1	23579.0	19	8.3	5387.0	24
5	57	Network Appliance	10767.1	38.6	87.7	1483.3	38	22.3	198.8	42
6	110	Hewlett-Packard	60543.8	-7.0	9.0	81845.0	10	22.3	3504.0	27
7	112	Lexmark International	10336.8	-2.6	61.2	5313.8	12	9.0	568.7	29
8	143	Motorola	37037.1	-4.1	40.2	31323.0	35	-0.2	2198.0	137
9	153	Jabil Circuit	5193.4	-8.1	37.9	6577.3	27	19.2	180.3	134
10	190	NCR	7220.9	74.2	86.6	5984.0	7	0.4	285.0	391
11	216	IBM	152348.9	-3.3	-3.5	96293.0	8	5.5	8448.0	11
12	229	EMC	30446.9	-11.6	15.9	8229.5	32	6.0	871.2	76
13	238	Xerox	14913.6	10.3	60.7	15722.0	0	-2.4	776.0	116
14	276	Avaya	6712.3	-18.4	161.7	4246.0	11	-12.8	294.0	989
15	291	Qlogic	3699.3	-3.6	8.2	543.0	5	16.4	144.3	10
16	306	Molex	4734.9	-20.3	-14.1	2493.0a	27	5.5	207.4	107
17	310	Scientific-Atlanta	4696.6	-6.6	38.8	1790.1	12	-4.2	238.8	42
18	312	Symbol Technologies	4270.1	4.3	106.6	1732.1	13	6.3	81.8	2379
19	366	Andrew	1948.0	-32.1	-28.0	1902.1	62	25.6	43.6	169
20	409	Sanmina-SCI	2884.0	-56.6	-45.7	12487.0	16	44.9	-6.4	NM
21	416	Tektronix	2582.7	-9.2	22.1	1018.6	26	-0.7	104.2	96
22	417	Agilent Technologies	11784.0	-29.8	-23.0	7196.0	14	0.2	381.0	NM
23	428	Comverse Technology	4578.3	1.7	48.3	903.3b	22	-12.4	41.2	NM
24	452	Sollectron	4769.8	-22.5	-40.1	11632.1	18	-10.4	-152.7	NM
25	454	Corning	16149.8	-8.6	70.4	3854.0y	25	-13.8	-2185.0	NM
26	457	ADC Telecommunications	1862.3	-23.3	-36.1	891.0	53	-23.9	28.6	81
27	459	Lucent Technologies	13557.1	-26.7	-16.3	9121.0	5	-23.3	1838.0	NM
28	466	Sun Microsystems	14254.6	-20.5	-50.4	11230.0	0	-7.3	-106.0	NM
29	477	Tellabs	3292.0	-26.5	-30.8	1231.8	26	-18.5	-29.8	NM
30	490	Gateway	1755.2	-13.4	2.2	3649.7	7	-15.3	-567.6	NM
31	491	JDS Uniphase	2759.1	-60.5	-60.6	710.9	14	-30.1	-106.0	NM
32	493	Ciena	1133.0	-65.4	-74.5	327.0	17	-35.3	-769.8	NM

RANK	NET MARGIN 2003	RETURN ON INVESTED CAPITAL	RETURN ON COMMON EQUITY	INVESTMENT DATA					
				RECENT SHARE PRICE \$	12-MONTH HIGH/LOW \$	P/E RATIO	DIVIDEND YIELD	EARNINGS PER SHARE 2004	ESTIMATED EARNINGS PER SHARE 2005
0	4.1	8.5	8.5	29	29/9	51	0.00	0.57	1.18
8	-7.8	1.7	3.0	17	25/11	70	0.00	0.25	0.37
6	-27.2	4.7	5.4	12	18/10	25	0.00	0.46	0.69
5	-0.5	7.7	8.4	30	35/23	28	0.00	1.06	0.95
7	-7.5	4.1	5.4	19	19/12	18	0.00	1.06	0.87
2	-14.3	10.8	14.6	15	27/13	18	0.00	0.84	-0.24
4	-3.2	17.0	17.3	10	21/8	37	0.00	0.27	0.15
4	-319.3	-12.9	-12.9	3	7/3	-9	0.00	-0.40	0.06
3	-18.2	-19.3	-28.7	6	11/4	-5	0.00	-1.21	0.21
5	3.7	7.6	14.3	23	28/18	33	0.18	0.69	1.04
1	29.2	17.7	17.7	36	45/31	33	0.78	1.08	1.18
2	2.0	8.8	8.8	45	45/12	72	0.00	0.62	1.04
2	6.4	43.5	46.9	40	43/31	34	0.00	1.18	1.60
8	21.9	22.7	22.7	17	25/17	22	0.00	0.79	0.89
4	13.1	12.2	12.2	30	35/16	57	0.00	0.53	0.79
3	3.7	8.3	9.3	21	24/16	18	1.54	1.17	1.51
7	9.2	25.5	27.3	80	98/78	19	0.00	4.28	4.52
0	4.0	12.3	16.5	16	21/14	17	1.02	0.91	0.93
7	1.5	8.0	9.3	26	31/19	30	0.00	0.87	1.23
8	1.0	11.9	13.7	39	39/20	26	0.00	1.48	1.29
8	8.5	19.0	28.4	93	99/82	19	0.78	4.94	5.62
6	8.0	7.5	7.6	13	15/9	35	0.00	0.36	0.51
9	2.3	4.7	9.9	16	17/13	20	0.00	0.78	0.95
9	0.7	19.9	24.0	14	18/12	23	0.00	0.62	0.81
6	25.3	16.0	16.0	40	45/21	26	0.00	1.53	1.90
3	5.1	9.9	9.9	25	33/24	23	0.60	1.09	1.05
3	10.5	12.6	12.6	31	37/25	20	0.13	1.54	1.52
7	0.2	6.6	7.6	18	19/11	54	0.11	0.33	0.58
2	1.4	2.3	2.7	12	22/9	47	0.00	0.26	0.56
1	-1.1	-0.1	-0.2	6	13/5	-551	0.00	-0.01	0.33
2	6.6	9.6	9.6	29	35/26	24	0.83	1.20	1.63
3	-25.6	7.7	10.1	24	35/20	31	0.00	0.77	1.12
6	-5.5	1.7	2.3	23	25/15	116	0.00	0.20	0.47
3	-30.5	-4.1	-6.1	5	7/4	-26	0.00	-0.19	0.23
7	-7.2	-36.1	-57.3	11	13/9	-7	0.00	-1.57	0.58
2	2.7	2.6	4.0	2	3/2	58	0.00	0.04	0.10
2	-1.9	35.0	NM	3	5/3	8	0.00	0.37	0.17
9	-12.9	-1.4	-1.6	4	6/3	-106	0.00	-0.04	0.04
2	-24.6	-1.1	-1.1	7	10/7	-101	0.00	-0.07	0.25
5	-15.1	NM	-235.1	5	7/4	-3	0.00	-1.45	0.15
4	-45.0	-5.4	-7.1	2	5/2	-24	0.00	-0.08	-0.07
4	-127.6	-43.1	-70.1	2	6/2	-1	0.00	-1.38	-0.18

Life After Carly

It was a deal that was supposed to shake up the computer industry. But after **HEWLETT-PACKARD CO.** (No. 110) bought Compaq Computer Corp. in 2002, CEO Carleton S. Fiorina struggled to deliver on her promise to reinvigorate the tech colossus. After a year in which HP stock underperformed nearly every competitor (down 7%), Fiorina is gone. Now new leadership will have to come up with a better game plan. The first order of business: figuring out whether to separate HP's strong printer business from its lackluster computer operations. With hungry competitors circling HP, it won't be an easy fix.



RANK		COMPANY	MARKET VALUE			SALES			PROFITABILITY		
INDUSTRY RANK	S&P 500 RANK		FEB. 28, 2005 \$ MIL.	TOTAL RETURN (1 YEAR)	TOTAL RETURN (3 YEAR)	12-MONTH 2004 \$ MIL.	CHANGE FROM 2003 %	3-YEAR AVERAGE CHANGE %	12-MONTH 2004 \$ MIL.	CHANGE FROM 2003 %	
22 MATERIALS											
Industry Average			11414.9	24.6	62.9	9166.4	14	9.9	549.5	97	
1	1	Nucor	9917.7	100.5	130.6	11376.8	82	39.1	1121.5	1686	
2	24	Phelps Dodge	10208.6	24.4	183.0	7089.3	71	20.0	1046.3	5681	
3	37	United States Steel	7109.2	70.6	262.0	13969.0	50	30.2	1077.0	NM	
4	45	Dow Chemical	52553.9	30.8	97.8	40161.0y	23	13.5	2797.0	61	
5	104	Weyerhaeuser	16181.4	5.2	177	22665.0	14	15.1	1283.0	345	
6	111	Ball	5003.5	38.8	115.6	5440.2	9	15.3	295.6	29	
7	119	Louisiana-Pacific	2887.1	77	164.6	2849.4	25	176	423.5	49	
8	127	Newmont Mining	20447.2	4.3	89.5	4590.0y	43	38.1	481.7	-6	
9	134	PPG Industries	12375.5	26.1	53.6	9513.0	9	5.5	683.0	37	
10	138	Praxair	14557.3	25.3	61.6	6594.0	17	8.6	697.0	19	
11	142	Air Products & Chemicals	14219.4	32.5	36.9	7717.5	18	11.4	639.1	58	
12	144	Rohm & Haas	10850.8	24.1	34.6	7300.0	14	9.1	496.0	72	
13	194	Ecolab	8165.7	173	40.1	4184.9	11	20.6	310.5	12	
14	224	DuPont	52963.1	21.9	25.3	27340.0y	1	4.2	1780.0	78	
15	248	Sigma-Aldrich	4251.1	9.0	39.2	1409.2	9	8.1	232.9	22	
16	274	Alcoa	27975.9	-12.7	-9.1	23478.0	11	1.2	1402.0	33	
17	322	Eastman Chemical	4578.8	41.4	49.6	6580.0y	13	71	170.0	NM	
18	328	Intl. Flavors & Fragrances	3894.7	14.9	26.6	2033.7	7	3.5	196.1	14	
19	334	Bemis	3191.3	19.6	12.4	2834.4	8	77	180.0	22	
20	347	Georgia-Pacific	9180.6	13.5	48.5	19656.0	0	-8.5	626.0	93	
21	350	Freeport-McMoRan Copper & Gold	7466.1	1.3	199.7	2371.9	7	9.5	202.3	3	
22	358	Allegheny Technologies	2357.2	96.6	74.4	2733.0	41	8.0	19.8	NM	
23	360	Temple-Inland	4490.6	28.0	577	4750.0	2	4.8	162.0	67	
24	368	Vulcan Materials	5925.3	25.0	28.3	2454.3	6	-7.3	261.4	10	
25	370	International Paper	18169.2	-13.5	-79	25532.0	7	-1.4	478.0	63	
26	384	Engelhard	3703.0	5.8	10.1	4166.4	12	-6.0	235.5	0	
27	394	Sealed Air	4368.0	4.9	16.2	3798.1	8	77	215.6	-10	
28	425	Pactiv	3351.4	5.2	18.8	3382.0	8	6.6	155.0	-21	
29	442	MeadWestvaco	6344.8	10.3	-0.2	8227.0	9	6.6	-347.0	NM	
30	451	Great Lakes Chemical	1375.1	6.7	18.5	1603.7	12	5.4	19.9	NM	
31	471	Hercules	1605.1	20.5	14.7	1997.0	8	4.4	20.0	-73	
INC	INC	Monsanto	15607.9	80.5	102.0	5527.0	NA	NA	222.0	NA	

23 TELECOMMUNICATION SERVICES

Industry Average			34580.0	9.0	51.7	23037.1	1	2.7	1126.3	-29	48
1	9	Nextel Communications	32667.3	11.1	489.8	13368.0	24	20.6	3002.0	98	47
2	154	Verizon Communications	99599.4	-2.3	-12.9	71283.0	6	1.8	7261.0	110	106
3	301	Sprint	34816.7	36.9	86.1	27428.0	5	23.3	-1012.0	NM	N
4	331	Alltel	17289.7	13.5	12.2	8246.1	3	4.1	1026.7	8	0
5	356	CenturyTel	4522.8	18.6	3.5	2410.9	2	13.5	337.2	-2	36
6	365	BellSouth	47239.8	-2.6	-26.1	20300.0	0	-6.1	3437.0	-1	12

	INVESTMENT DATA								
	NET MARGIN 2003	RETURN ON INVESTED CAPITAL	RETURN ON COMMON EQUITY	RECENT SHARE PRICE \$	12-MONTH HIGH/LOW \$	P-E RATIO	DIVIDEND YIELD	EARNINGS PER SHARE 2004	ESTIMATED EARNINGS PER SHARE 2005
	3.5	8.9	14.1	47	50/34	19	1.62	2.54	3.17
	1.0	24.6	32.5	62	64/28	9	0.96	7.02	6.49
	0.4	17.6	23.8	106	108/60	10	0.94	10.58	10.78
	-4.4	19.8	26.7	62	64/25	7	0.51	8.37	7.95
	5.3	11.0	22.8	55	56/36	19	2.43	2.93	4.38
	1.4	6.6	13.9	67	69/55	12	2.39	5.43	4.94
	4.6	11.2	27.2	44	45/30	17	0.90	2.60	2.89
	12.5	17.7	24.0	26	28/21	7	1.52	3.87	2.15
	15.9	4.8	6.1	45	50/35	41	0.89	1.09	1.41
	5.7	14.1	19.1	72	73/55	18	2.50	3.95	4.79
	10.4	10.4	19.3	45	46/35	21	1.61	2.10	2.41
	6.2	8.9	13.5	63	63/47	23	1.85	2.78	3.12
	4.5	7.8	13.4	48	49/36	22	2.08	2.21	2.63
	7.4	14.9	21.1	32	36/27	27	1.10	1.19	1.33
	3.7	10.4	17.3	53	54/40	30	2.63	1.77	2.78
	14.7	16.8	19.2	62	64/53	18	1.23	3.34	3.54
	5.0	7.0	10.5	32	39/28	20	1.87	1.60	2.12
	-4.7	5.2	14.3	58	58/39	26	3.05	2.18	3.73
	9.1	12.4	21.6	41	43/33	20	1.70	2.05	2.40
	5.6	9.8	13.8	30	30/25	18	2.41	1.67	1.86
	1.6	4.5	10.4	36	39/30	15	1.96	2.38	3.01
	8.9	4.8	13.5	42	45/28	49	2.39	0.85	3.23
	-16.2	2.0	4.6	25	26/9	112	0.98	0.22	1.80
	2.1	1.8	7.7	80	82/57	28	2.24	2.87	4.31
	10.3	10.0	13.0	58	59/42	23	2.01	2.52	2.99
	1.2	2.0	5.8	37	45/37	38	2.68	0.98	2.09
	6.4	12.2	16.7	30	33/26	16	1.59	1.88	1.98
	6.8	6.3	16.2	52	54/44	23	0.00	2.25	2.97
	6.2	7.9	14.3	23	26/20	22	0.00	1.01	1.34
	0.3	-4.5	-8.0	31	34/25	-18	2.93	-1.72	1.53
	-2.8	1.5	2.3	27	30/22	68	1.50	0.39	1.23
	4.0	1.6	NM	14	15/10	80	0.00	0.18	1.07
	NA	3.4	4.1	59	60/31	73	1.16	0.81	2.05
	7.0	0.2	8.1	27	29/22	51	3.17	0.52	1.65
	14.0	16.6	31.5	29	31/21	11	0.00	2.62	1.79
	5.1	7.5	20.6	36	42/34	14	4.28	2.59	2.55
	-1.1	-3.4	-7.4	24	26/16	-33	2.11	-0.71	1.37
	11.9	8.2	14.4	57	61/49	17	2.66	3.33	3.44
	14.6	5.5	9.9	34	36/26	14	0.71	2.41	2.30
	17.1	9.0	14.8	26	29/24	14	4.19	1.87	1.65

Out of The Woods?

The modern office is turning out to be anything but paperless—and that's excellent news for **WEYERHAEUSER CO.** (No. 104). Two years ago the paper producer was mired in overcapacity and had to slash production. As the economy picked up in 2004, though, demand for paper and packaging surged. That more than quadrupled Weyerhaeuser's profits, to \$1.3 billion. But the company's own costs have been rising, too. Price hikes for natural gas and transportation cut into profits at its building-products unit. That's why investors didn't give Weyerhaeuser's stock nearly the lift that others in this sector received.



MARK COOPER/CORBIS

RANK	COMPANY		MARKET VALUE			SALES			PROFITABILITY	
			FEB 28 2005 \$ MIL	TOTAL RETURN (1 YEAR)	TOTAL RETURN (3 YEAR)	12-MONTH 2004 \$ MIL	CHANGE FROM 2003 %	3-YEAR AVERAGE CHANGE %	12-MONTH 2004 \$ MIL	CHANGE FROM 2003 %
7	371	SBC Communications	82598.0	5.4	-26.2	40787.0	1	-4.1	5045.0	-14
8	432	Citizens Communications	4466.4	21.4	75.6	2202.0a	-14	-1.4	70.3	-15
9	467	AT&T	15516.2	2.7	-29.4	30537.0	-12	-15.8	-6110.0	NM
10	486	Qwest Communications Intl.	7083.9	-14.8	-55.2	13809.0	-3	-9.2	-1794.0	NM

24 UTILITIES

Industry Average			10543.2	22.5	35.4	8784.9	5	2.3	644.9	59
1	59	Constellation Energy Group	9074.2	33.2	95.6	12549.7y	30	52.8	602.0	23
2	66	PG&E	13802.8	24.9	65.9	11080.0	6	-2.9	3820.0	383
3	84	Sempra Energy	9367.0	29.9	99.7	9410.0y	19	8.9	930.0	32
4	137	Dominion Resources	24490.2	19.3	40.1	13972.0y	16	10.6	1280.0	33
5	169	Exelon	30128.1	39.9	104.1	14515.0y	-8	-0.3	1841.0	132
6	196	AES	10847.5	84.8	224.4	9471.0	13	8.0	376.0	12
7	239	Entergy	15569.0	20.3	83.9	10123.7y	10	2.6	933.0	15
8	245	FirstEnergy	13602.4	10.9	28.0	12453.0y	7	13.8	873.8	106
9	253	FPL Group	14773.1	24.4	66.2	10522.0y	9	8.9	887.0	-1
10	262	PPL	10310.4	21.3	87.3	5812.0y	4	4.4	702.0	-6
11	263	Southern	23800.9	11.0	45.5	11903.0y	6	5.5	1561.2	4
12	280	KeySpan	6360.4	9.1	43.1	6650.5y	2	1.0	614.7	44
13	292	Ameren	10046.9	14.7	50.2	5160.0y	12	11.1	541.0	5
14	303	Public Service Enterprise Group	12966.4	21.5	51.7	10996.0y	-1	17.8	730.0	-15
15	329	American Electric Power	13216.2	1.0	-9.8	14100.0	-4	4.1	1160.0	377
16	343	Progress Energy	10705.0	-0.9	13.2	9772.0	12	8.3	753.0	-7
17	348	Duke Energy	25316.6	28.8	-10.5	22503.0y	2	10.1	1232.0	NM
18	392	NiSource	6127.0	8.9	26.1	6666.2y	7	-8.5	434.6	1
19	401	TXU	22243.8	176.2	63.2	9308.0y	8	-3.6	81.0	-86
20	404	DTE Energy	7692.4	14.8	23.9	7114.0y	1	6.9	443.0	-8
21	408	Edison International	10582.3	45.1	114.0	10495.0ay	-3	0.6	158.0	-73
22	426	Consolidated Edison	10367.5	2.1	23.1	9758.0	-1	2.6	560.0	-13
23	429	CINergy	7585.3	8.3	48.3	4688.0	6	-25.7	404.3	-8
24	435	Xcel Energy	7086.5	6.2	-8.9	8345.3y	6	-7.2	526.9	0
25	438	CenterPoint Energy	3687.1	18.7	-14.6	8411.7a	8	-21.1	115.0	-66
26	444	Pinnacle West Capital	3823.1	11.7	18.7	2899.7y	5	-3.4	235.2	4
27	445	Peoples Energy	1620.0	0.8	34.9	2392.7y	9	9.7	72.7	-30
28	446	Allegheny Energy	2600.6	43.5	-41.9	2756.1y	26	-34.9	134.8	NM
29	456	Nicor	1644.6	8.7	4.3	2739.7	3	8.1	75.1	-32
30	474	Calpine	1767.8	-39.9	-55.0	9229.9	4	11.8	-418.0	NM
31	475	CMS Energy	1965.5	32.0	-41.2	5282.0a	-10	-16.8	38.0	NM
32	481	Dynegy	1580.4	1.7	-83.6	6153.0	6	-9.7	-10.0	NM
33	488	Teco Energy	3174.0	11.4	-22.4	2669.1y	3	1.9	-404.4	NM

INVESTMENT DATA

NET MARGIN 2003	RETURN ON INVESTED CAPITAL	RETURN ON COMMON EQUITY	RECENT SHARE PRICE \$	12-MONTH HIGH/LOW \$	P/E RATIO	DIVIDEND YIELD	EARNINGS PER SHARE 2004	ESTIMATED EARNINGS PER SHARE 2005
14.5	8.2	12.4	24	27/23	16	5.36	1.52	1.42
3.2	1.2	5.1	13	15/11	58	7.50	0.23	0.46
5.4	-37.8	-82.8	19	21/14	-3	4.89	-7.68	1.87
-9.2	-12.7	NM	4	5/3	-4	0.00	-1.00	-0.35

4.9	4.3	11.6	38	40/29	17	3.46	2.21	2.51
5.0	6.0	12.0	51	54/36	15	2.60	3.40	3.45
7.6	22.5	42.8	35	36/26	4	3.41	8.97	2.26
8.9	9.8	18.2	40	41/31	10	2.90	3.93	3.20
8.0	4.6	10.8	72	73/61	19	3.72	3.82	5.05
5.0	8.5	19.3	45	46/31	16	3.53	2.75	3.05
4.0	1.9	21.6	17	17/8	29	0.00	0.58	0.84
8.8	5.5	9.9	69	72/51	18	3.13	3.93	4.69
3.6	4.5	9.7	41	43/37	16	4.00	2.66	2.82
9.3	5.7	11.8	79	80/60	16	3.58	4.91	5.14
13.4	6.2	16.3	55	56/40	15	3.37	3.76	4.09
13.4	6.5	14.1	32	34/27	16	4.45	2.06	2.10
6.5	7.3	15.6	40	42/34	10	4.60	3.78	2.37
11.2	4.8	8.8	51	52/41	18	4.94	2.84	3.07
7.7	3.9	12.9	55	55/38	18	4.11	3.05	3.28
1.7	5.9	13.8	33	36/29	11	4.19	2.91	2.42
9.3	4.4	9.7	43	48/40	14	5.45	3.10	3.48
-4.5	3.5	7.4	27	28/19	21	4.08	1.27	1.53
6.9	4.4	8.8	23	23/20	14	4.06	1.62	1.53
6.6	0.5	9.2	76	79/27	381	2.95	0.20	5.58
6.8	3.4	8.1	44	45/38	17	4.66	2.55	3.49
5.3	0.9	2.6	32	33/22	71	3.08	0.46	2.16
6.6	4.0	7.6	43	46/37	18	5.33	2.32	2.84
9.9	4.8	9.6	40	43/35	19	4.75	2.18	2.82
6.7	4.3	9.8	18	19/15	14	4.68	1.27	1.26
4.3	1.0	18.0	12	12/10	32	3.34	0.37	0.64
8.2	4.2	7.9	42	46/36	16	4.55	2.57	3.01
4.8	4.1	8.2	43	46/39	22	5.10	1.93	2.74
-13.9	2.2	9.1	19	20/12	19	0.00	0.99	0.88
4.1	6.0	10.0	37	40/32	22	4.99	1.70	2.21
1.0	-1.9	-9.2	3	6/2	-3	0.00	-0.97	-0.72
-8.8	0.2	1.1	12	13/8	93	0.00	0.13	0.79
-12.3	-0.5	-1.3	4	6/3	-46	0.00	-0.09	-0.28
2.4	-7.8	-31.5	16	16/11	-8	4.78	-2.10	1.02

Powered Up in California

Just a few years ago, **PG&E CORP.** (No. 66) was a utility with national ambitions, owning gas pipelines in the Northwest and power plants in New England. Then came the California power crisis. Stuck with soaring debts, the San Francisco company put its core utility serving 14 million Northern Californians into bankruptcy. It later handed its out-of-state assets over to creditors. That process resulted in a huge noncash gain, which explains the company's 383% earnings increase. Now back to its roots, PG&E plans to invest \$2 billion a year in existing plants and transmission lines.



JUSTIN SULLIVAN/GETTY IMAGES

The Alphabetical List

S&P 500

Here is a quick guide to this page: To the left of the company name is its position in *BusinessWeek* overall ranking of the companies in the S&P 500. To the right of the name are the company ticker symbol and the number of its industry group, followed by the company's rank among the 500 in market value, 12-month sales, and 12-month profits.

RANK COMPANY		OTHER RANKINGS			RANK COMPANY		OTHER RANKINGS		
	SYMBOL (INDUSTRY GROUP)	MARKET VALUE	SALES	PROFITS		SYMBOL (INDUSTRY GROUP)	MARKET VALUE	SALES	P
A									
90	Abbott Laboratories ABT (15)	30	97	39	329	American Electric Power AEP (24)	207	127	121
145	ACE ACE (12)	215	149	124	124	American Express AXP (11)	32	61	33
457	ADC Telecommunications ADCT (21)	483	483	458	130	American International Group AIG (12)	9	9	7
28	Adobe Systems ADBE (19)	180	443	261	269	American Power Conversion APCC (16)	423	440	393
354	Advanced Micro Devices AMD (20)	357	304	434	234	American Standard ASD (16)	271	199	329
196	AES AES (24)	242	200	305	231	AmerisourceBergen ABC (14)	354	22	271
63	Aetna AET (14)	115	95	117	106	Amgen AMGN (15)	27	174	56
294	Affiliated Computer Services ACS (19)	351	336	302	413	AmSouth Bancorporation ASO (10)	287	367	205
70	AFLAC AFL (12)	132	137	105	49	Anadarko Petroleum APC (9)	133	266	84
417	Agilent Technologies A (21)	229	239	301	172	Analog Devices ADI (20)	199	388	224
142	Air Products & Chemicals APD (22)	190	232	200	366	Andrew ANDW (21)	480	426	453
179	Alberto-Culver ACV (8)	398	352	389	293	Anheuser-Busch BUD (7)	67	119	60
433	Albertson's ABS (6)	298	38	278	295	Aon AOC (12)	313	180	193
274	Alcoa AA (22)	85	75	98	10	Apache APA (9)	121	290	82
446	Allegheny Energy AYE (24)	466	376	420	470	Apartment Investment & Mgmt. AIV (13)	439	454	450
358	Allegheny Technologies ATI (22)	472	379	464	174	Apollo Group APOL (17)	205	424	336
217	Allergan AGN (15)	270	416	303	14	Apple Computer AAPL (21)	71	191	240
489	Allied Waste Industries AW (17)	465	286	448	423	Applied Biosystems Group ABI (15)	425	436	383
67	Allstate ALL (12)	70	49	36	131	Applied Materials AMAT (20)	84	222	89
331	Alltel AT (23)	152	221	132	475	Applied Micro Circuits AMCC (20)	497	497	475
149	Altera ALTR (20)	316	478	352	94	Archer Daniels Midland ADM (7)	166	41	188
148	Altria Group MO (7)	12	17	10	330	Archstone-Smith Trust ASN (13)	345	482	409
221	Ambac Financial Group ABK (12)	294	459	184	168	Ashland ASH (9)	401	214	260
86	Amerada Hess AHC (9)	283	109	136	467	AT&T T (23)	172	55	496
292	Ameren AEE (24)	265	295	231	25	Autodesk ADSK (19)	342	469	371
					287	Automatic Data Processing ADP (19)	97	225	135
					338	AutoNation AN (5)	386	99	289
					282	AutoZone AZO (5)	317	274	222

RANK	COMPANY SYMBOL (INDUSTRY GROUP)	OTHER RANKINGS		
		MARKET VALUE	SALES	PROFITS
76	Avaya AV (21)	346	330	342
17	Avery Dennison AVY (17)	363	287	350
87	Avon Products AVP (8)	123	231	158
B				
63	Baker Hughes BHI (9)	165	263	236
111	Ball BLL (22)	391	281	341
50	Bank of America BAC (10)	8	16	4
05	Bank of New York BK (11)	102	241	95
60	Bard (C.R.) BCR (14)	339	445	337
02	Bausch & Lomb BOL (14)	433	405	403
03	Baxter International BAX (14)	112	198	299
72	BB&T BBT (10)	114	251	88
05	Bear Stearns BSC (11)	260	217	99
60	Becton, Dickinson BDx (14)	177	303	198
20	Bed Bath & Beyond BBBY (5)	235	305	254
65	BellSouth BLS (23)	56	90	35
34	Bemis BMS (22)	449	374	396
83	Best Buy BBY (5)	146	69	155
62	Big Lots BLI (5)	494	326	457
02	Biogen Idec BILB (15)	213	406	452
185	Biomet BMET (14)	247	437	326
135	BJ Services BJS (9)	304	378	293
65	Black & Decker BDK (2)	343	283	265
313	Block (H&R) HRB (17)	290	331	220
458	BMC Software BMC (19)	446	456	431
233	Boeing BA (16)	63	24	75
30	Boston Scientific BSX (14)	90	275	130
346	Bristol-Myers Squibb BMY (15)	55	100	54
311	Broadcom BRCM (20)	248	398	372
271	Brown-Forman BFB (7)	358	402	334
79	Brunswick BC (2)	410	293	353
200	Burlington Northern Santa Fe BNI (18)	137	169	167
20	Burlington Resources BR (9)	131	276	92

C				
474	Calpine CPN (24)	484	207	483
325	Campbell Soup CPB (7)	236	234	196
115	Capital One Financial COF (11)	139	171	91
260	Cardinal Health CAH (14)	95	15	112
22	Caremark Rx CMX (14)	151	70	211
27	Carnival CCL (3)	62	194	71
23	Caterpillar CAT (16)	75	56	66
100	Cendant CD (17)	104	96	76
438	CenterPoint Energy CNP (24)	438	216	423
62	Centex CTX (2)	307	154	150
356	CenturyTel CTL (23)	408	396	317
3	ChevronTexaco CVX (9)	14	6	5

RANK	COMPANY SYMBOL (INDUSTRY GROUP)	OTHER RANKINGS		
		MARKET VALUE	SALES	PROFITS
472	Chiron CHIR (15)	348	448	447
40	Chubb CB (12)	174	141	90
493	Ciena CIEN (21)	496	494	488
136	Cigna CI (14)	219	105	85
161	Cincinnati Financial CINF (12)	325	347	216
429	CINergy CIN (24)	320	312	285
342	Cintas CTAS (17)	324	371	345
335	Circuit City Stores CC (5)	454	181	444
46	Cisco Systems CSCO (21)	16	73	19
443	CIT Group CIT (11)	295	313	175
228	Citigroup C (11)	4	8	2
432	Citizens Communications CZN (23)	411	409	445
252	Citrix Systems CTXS (19)	434	487	421
421	Clear Channel Communications CCU (4)	134	201	159
374	Clorox CLX (8)	281	325	229
475	CMS Energy CMS (24)	479	291	456
17	Coach COH (2)	249	453	324
198	Coca-Cola KO (7)	17	83	23
393	Coca-Cola Enterprises CCE (7)	266	106	212
318	Colgate-Palmolive CL (8)	87	172	101
296	Comcast CMCSA (4)	29	89	137
410	Comerica CMA (10)	274	362	173
378	Compass Bancshares CBSS (10)	373	429	307
434	Computer Associates Intl. CA (19)	164	350	461
241	Computer Sciences CSC (19)	289	126	234
453	Compuware CPWR (19)	464	468	436
428	Comverse Technology CMVT (21)	407	481	454
372	ConAgra Foods CAG (7)	195	116	172
2	ConocoPhillips COP (9)	28	7	13
426	Consolidated Edison ED (24)	258	192	226
59	Constellation Energy Group CEG (24)	285	144	210
460	Convergys CVG (19)	477	393	424
244	Cooper Industries CBE (16)	352	323	313
463	Cooper Tire & Rubber CTB (1)	492	415	459
454	Corning GLW (21)	163	338	494
122	Costco Wholesale COST (6)	111	26	149
108	Countrywide Financial CFC (10)	124	128	58
324	CSX CSX (18)	288	226	277
29	Cummins CMI (16)	448	215	311
74	CVS CVS (6)	127	54	139

D				
447	Dana DCN (1)	476	212	432
43	Danaher DHR (16)	157	247	177
357	Darden Restaurants DRI (3)	421	298	359
36	Deere DE (16)	148	86	94
15	Dell DELL (21)	20	25	40
450	Delphi DPH (1)	430	62	414
479	Delta Air Lines DAL (18)	499	118	495
11	Devon Energy DVN (9)	109	208	62

RANK	COMPANY	OTHER RANKINGS		
		MARKET VALUE	SALES	PROFITS
376	Dillard's DDS (5)	481	229	446
150	Disney (Walt) DIS (4)	45	53	53
176	Dollar General DG (5)	340	233	330
137	Dominion Resources D (24)	100	129	108
175	Donnelley (R.R.) RRD (17)	327	240	354
214	Dover DOV (16)	312	280	282
45	Dow Chemical DOW (22)	50	33	45
464	Dow Jones DJ (4)	452	442	429
404	DTE Energy DTE (24)	318	242	263
348	Duke Energy DUK (24)	96	82	115
224	DuPont DD (22)	49	67	79
481	Dynegy DYN (24)	490	261	469

E

307	E*Trade Financial ET (11)	393	413	310
322	Eastman Chemical EMN (22)	406	254	397
375	Eastman Kodak EK (2)	273	135	390
51	Eaton ETN (16)	250	188	199
19	eBay EBAY (5)	43	355	169
194	Ecolab ECL (22)	302	334	333
408	Edison International EIX (24)	251	176	404
478	El Paso EP (9)	309	264	481
34	Electronic Arts ERTS (19)	129	359	215
448	Electronic Data Systems EDS (19)	239	87	479
229	EMC EMC (21)	80	223	157
195	Emerson Electric EMR (16)	88	112	103
384	Engelhard EC (22)	436	335	365
239	Entergy ETR (24)	171	182	143
31	EOG Resources EOG (9)	243	404	204
302	Equifax EFX (17)	426	466	364
465	Equity Office Properties Trust EOP (13)	220	356	408
449	Equity Residential EQR (13)	279	427	419
169	Exelon EXC (24)	81	123	72
113	Express Scripts ESRX (14)	375	115	351
7	Exxon Mobil XOM (9)	1	2	1

F

297	Family Dollar Stores FDO (5)	377	282	357
INC	Fannie Mae FNM (10)	44	NR	NR
353	Federated Department Stores FD (5)	277	114	192
385	Federated Investors FII (11)	451	485	386
39	FedEx FDX (18)	82	66	104
418	Fifth Third Bancorp FITB (10)	99	255	93
99	First Data FDC (19)	73	184	69
406	First Horizon National FHN (10)	382	389	257
245	FirstEnergy FE (24)	202	148	156
193	Fiserv FISV (19)	328	342	292
126	Fisher Scientific International FSH (14)	334	314	400
266	Fluor FLR (16)	381	205	391
207	Ford Motor F (1)	105	4	32

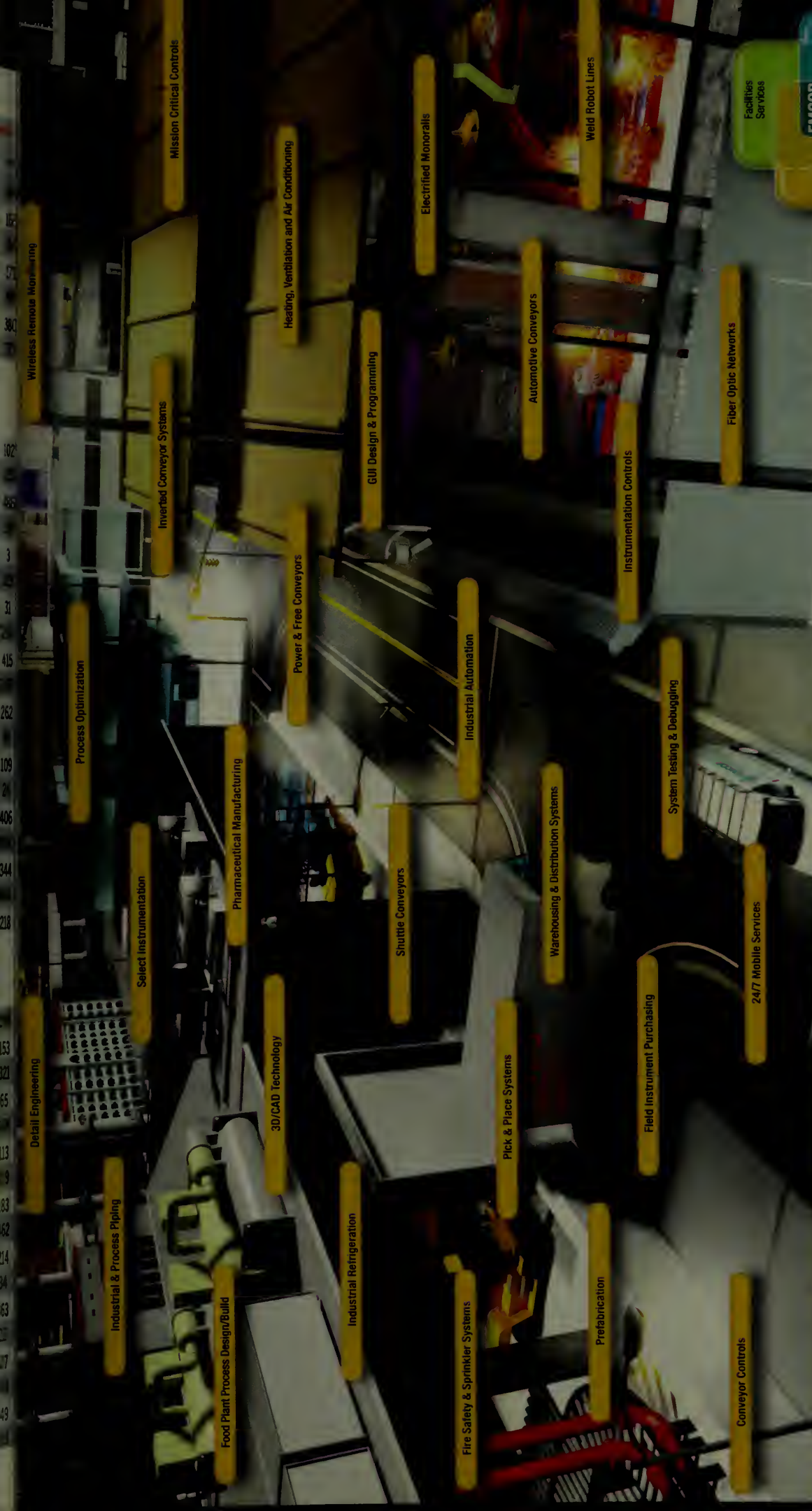
RANK	COMPANY	OTHER RANKINGS		
		MARKET VALUE	SALES	PROFITS
102	Forest Laboratories FRX (15)	175	350	14
72	Fortune Brands FO (2)	232	245	16
253	FPL Group FPL (24)	184	175	15
71	Franklin Resources BEN (11)	149	346	17
INC	Freddie Mac FRE (10)	65	NR	NR
350	Freeport-McMoRan Copper & Gold FCX (22)	326	401	38
407	Freescale Semiconductor FSLB (20)	319	273	37

G

289	Gannett GCI (4)	126	235	102
140	Gap GPS (5)	138	110	123
490	Gateway GTW (21)	486	343	48
118	General Dynamics GD (16)	116	101	118
227	General Electric GE (16)	2	5	3
186	General Mills GIS (7)	135	164	123
321	General Motors GM (1)	125	3	31
250	Genuine Parts GPC (5)	321	210	290
191	Genzyme General GENZ (15)	214	410	415
347	Georgia-Pacific GP (22)	284	98	201
47	Gilead Sciences GILD (15)	181	463	262
69	Gillette G (8)	53	177	31
246	Golden West Financial GDW (10)	136	322	109
116	Goldman Sachs Group GS (11)	51	59	24
319	Goodrich GR (16)	412	310	406
395	Goodyear Tire & Rubber GT (1)	470	107	464
258	Grainger (W.W.) GWW (16)	370	302	344
451	Great Lakes Chemical GLK (22)	493	449	463
204	Guidant GDT (14)	103	341	218

H

129	Halliburton HAL (9)	130	88	298
128	Harley-Davidson HDI (1)	143	288	153
240	Harrah's Entertainment HET (3)	329	321	321
82	Hartford Financial Services HIG (12)	117	79	65
373	Hasbro HAS (2)	435	369	384
236	HCA HCA (14)	108	74	113
212	Health Management Associates HMA (14)	372	354	319
299	Heinz (H.J.) HNZ (7)	209	213	183
471	Hercules HPC (22)	489	420	452
152	Hershey Foods HSY (7)	173	324	214
110	Hewlett-Packard HPQ (21)	39	11	34
316	Hilton Hotels HLT (3)	303	333	363
89	Home Depot HD (5)	22	13	22
314	Honeywell International HON (16)	77	71	107
364	Hospira HSP (14)	404	386	340
109	Humana HUM (14)	378	139	349
415	Huntington Bancshares HBAN (10)	383	411	288



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RANK	COMPANY	OTHER RANKINGS		
		MARKET VALUE	SALES	PROFITS
	SYMBOL (INDUSTRY GROUP)			
I				
85	Illinois Tool Works ITW (16)	91	156	100
277	IMS Health RX (14)	374	451	346
101	Ingersoll-Rand IR (16)	187	204	161
55	Intel INTC (20)	11	48	14
216	International Business Machines IBM (21)	10	10	12
328	International Flavors & Fragrances IFF (22)	427	418	385
192	International Game Technology IGT (3)	253	391	269
370	International Paper IP (22)	145	72	250
487	Interpublic Group IPG (4)	376	265	487
304	Intuit INTU (19)	306	425	322
147	ITT Industries ITT (16)	305	248	267

J				
153	Jabil Circuit JBL (21)	385	256	394
468	Janus Capital Group JNS (11)	445	479	398
491	JDS Uniphase JDSU (21)	462	488	474
309	Jefferson-Pilot JP (12)	347	337	223
26	Johnson & Johnson JNJ (15)	7	27	11
170	Johnson Controls JCI (1)	237	68	163
437	Jones Apparel Group JNY (2)	428	315	339
242	JPMorgan Chase JPM (11)	15	18	26

K				
56	KB Home KBH (2)	395	244	248
184	Kellogg K (7)	144	196	152
183	Kerr-McGee KMG (9)	228	294	286
349	KeyCorp KEY (10)	204	278	141
280	KeySpan KSE (24)	353	252	208
219	Kimberly-Clark KMB (8)	78	117	80
208	Kinder Morgan KMI (9)	269	473	235
480	King Pharmaceuticals KG (15)	473	464	465
283	KLA-Tencor KLAC (20)	275	428	287
397	Knight-Ridder KRI (4)	392	368	323
215	Kohl's KSS (5)	160	158	181
440	Kroger KR (6)	208	19	378

L				
93	L-3 Communications Holdings LLL (16)	314	246	300
243	Laboratory Corp. of America LH (14)	349	363	309
273	Leggett & Platt LEG (2)	380	300	347
151	Lehman Brothers Holdings LEH (11)	98	84	55
112	Lexmark International LXX (21)	259	289	221
333	Lilly (Eli) LLY (15)	36	131	77
222	Limited Brands LTD (5)	276	203	179
359	Lincoln National LNC (12)	301	284	180

RANK	COMPANY	OTHER RANKINGS		
		MARKET VALUE	SALES	PROFITS
	SYMBOL (INDUSTRY GROUP)			
177	Linear Technology LLTC (20)	225	480	29
226	Liz Claiborne LIZ (2)	405	316	32
81	Lockheed Martin LMT (16)	93	46	11
363	Loews LTR (12)	206	122	11
119	Louisiana-Pacific LPX (22)	456	373	27
64	Lowe's LOW (5)	57	43	6
495	LSI Logic LSI (20)	471	439	48
459	Lucent Technologies LU (21)	203	209	73

M				
279	M&T Bank MTB (10)	234	357	19
285	Manor Care HCR (14)	455	358	39
54	Marathon Oil MRO (9)	161	29	11
125	Marriott International MAR (3)	188	183	21
455	Marsh & McLennan MMC (12)	154	152	39
290	Marshall & Ilsley MI (10)	282	361	20
97	Masco MAS (16)	176	153	14
268	Mattel MAT (2)	291	299	21
146	Maxim Integrated Products MXIM (20)	196	444	23
380	May Department Stores MAY (5)	264	125	23
492	Maytag MYG (2)	495	311	45
389	MBIA MBI (12)	297	421	164
223	MBNA KRB (11)	76	150	49
267	McCormick MKC (7)	387	390	376
95	McDonald's MCD (3)	66	102	59
156	McGraw-Hill MHP (4)	150	292	174
237	McKesson MCK (14)	238	12	78
442	MeadWestvaco MWV (22)	355	224	480
257	Medco Health Solutions MHS (14)	218	47	21
484	MedImmune MEDI (15)	366	474	466
53	Medtronic MDT (14)	37	185	63
352	Mellon Financial MEL (11)	221	307	165
326	Merck MRK (15)	31	77	18
218	Mercury Interactive MERQ (19)	429	490	435
336	Meredith MDP (4)	474	471	422
188	Merrill Lynch MER (11)	48	51	27
76	MetLife MET (12)	79	35	48
398	MGIC Investment MTG (10)	359	447	227
379	Micron Technology MU (20)	338	320	332
42	Microsoft MSFT (19)	3	37	9
369	Millipore MIL (14)	475	484	426
306	Molex MOLXE (21)	400	392	379
337	Molson Coors Brewing TAP (7)	362	328	382
INC	Monsanto MON (22)	168	279	370
308	Monster Worldwide MNST (17)	441	486	442
114	Moody's MCO (11)	216	457	272
256	Morgan Stanley MWD (11)	38	34	25
143	Motorola MOT (21)	68	52	61
461	Mylan Laboratories MYL (15)	399	467	360

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RANK	COMPANY	OTHER RANKINGS		
	SYMBOL (INDUSTRY GROUP)	MARKET VALUE	SALES	PROFITS
N				
249	Nabors Industries NBR (9)	292	399	338
211	National City NCC (10)	106	190	47
155	National Semiconductor NSM (20)	335	414	291
340	Navistar International NAV (16)	461	195	358
190	NCR NCR (21)	332	268	348
57	Network Appliance NTAP (21)	245	455	381
422	New York Times NYT (4)	379	353	343
483	Newell Rubbermaid NWL (2)	361	249	470
127	Newmont Mining NEM (22)	122	319	246
INC	News Corp. NWS.A (4)	54	NR	NR
9	Nextel Communications NXTL (23)	74	136	42
456	Nicor GAS (24)	487	377	441
48	Nike NKE (2)	107	140	127
392	NiSource NI (24)	360	250	270
377	Noble NE (9)	315	476	416
80	Nordstrom JWN (5)	323	237	294
107	Norfolk Southern NSC (18)	191	236	148
261	North Fork Bancorporation NFB (10)	201	432	228
430	Northern Trust NTRS (11)	280	375	242
123	Northrop Grumman NOC (16)	141	58	126
390	Novell NOVL (19)	478	472	264
386	Novellus Systems NVLS (20)	424	461	405
1	Nucor NUE (22)	268	162	125
345	NVIDIA NVDA (20)	396	419	428

O				
6	Occidental Petroleum OXY (9)	89	163	50
265	Office Depot ODP (5)	365	134	315
173	OfficeMax OMX (5)	460	142	392
206	Omnicom Group OMC (4)	155	193	185
187	Oracle ORCL (19)	34	173	44

P				
16	Paccar PCAR (16)	210	161	151
425	Pactiv PTV (22)	444	351	410
298	Pall PLL (16)	443	430	407
396	Parametric Technology PMTC (19)	491	491	440
105	Parker Hannifin PH (16)	311	230	251
255	Paychex PAYX (19)	223	460	327
164	Penney (J.C.) JCP (5)	224	104	195
445	Peoples Energy PGL (24)	488	400	443
320	Pepsi Bottling Group PBG (7)	344	170	256
98	PepsiCo PEP (7)	21	60	28
351	PerkinElmer PKI (14)	459	441	430
78	Pfizer PFE (15)	6	23	6
66	PG&E PCG (24)	198	167	30
24	Phelps Dodge PD (22)	263	243	131

RANK	COMPANY SYMBOL (INDUSTRY GROUP)	OTHER RANKINGS		
		MARKET VALUE	SALES	PROFITS
444	Pinnacle West Capital PNW (24)	431	372	365
339	Pitney Bowes PBI (17)	252	306	249
171	Plum Creek Timber PCL (13)	341	452	314
427	PMC-Sierra PMCS (20)	485	495	451
327	PNC Financial Services Group PNC (10)	183	259	113
485	Power-One PWER (16)	500	496	471
134	PPG Industries PPG (22)	217	197	194
262	PPL PPL (24)	261	271	190
138	Praxair PX (22)	186	253	191
96	Price (T. Rowe) Group TROW (11)	308	465	316
281	Principal Financial Group PFG (11)	231	219	189
58	Procter & Gamble PG (8)	13	21	17
343	Progress Energy PGN (24)	246	189	176
21	Progressive PGR (12)	140	133	83
381	ProLogis PLD (13)	330	492	367
213	Provident Financial PVN (11)	389	385	276
117	Prudential Financial PRU (12)	83	63	57
303	Public Service Enterprise Group PEG (24)	212	168	182
12	Pulte Homes PHM (2)	267	157	134

Q,R

291	Qlogic QLGC (21)	437	493	417
13	Qualcomm QCOM (21)	41	301	74
157	Quest Diagnostics DGX (14)	272	297	243
486	Qwest Communications Intl. Q (23)	337	132	492
361	RadioShack RSH (5)	403	308	318
220	Raytheon RTN (16)	153	91	266
251	Reebok International RBK (2)	469	340	387
254	Regions Financial RF (10)	178	317	162
203	Reynolds American RAI (7)	222	258	202
178	Robert Half International RHI (17)	388	383	418
68	Rockwell Automation ROK (16)	233	318	275
92	Rockwell Collins COL (16)	300	365	325
144	Rohm & Haas ROH (22)	241	238	244
405	Rowan RDC (9)	442	489	460
259	Ryder System R (18)	463	296	374

S

424	Sabre Holdings TSG (19)	458	412	388
165	Safeco SAFC (12)	364	260	206
439	Safeway SWY (6)	299	45	225
409	Sanmina-SCI SANM (21)	457	146	467
232	Sara Lee SLE (7)	147	94	97
371	SBC Communications SBC (23)	25	31	21
469	Schering-Plough SGP (15)	86	220	489
166	Schlumberger SLB (9)	60	160	133
400	Schwab (Charles) SCH (11)	193	332	279
316	Scientific-Atlanta SFA (21)	402	434	362
394	Sealed Air SEE (22)	415	339	375
431	Sears, Roebuck S (5)	244	44	320

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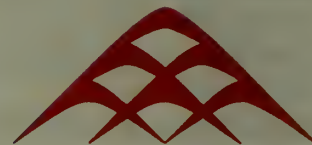
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RANK	COMPANY	OTHER RANKINGS		
	SYMBOL (INDUSTRY GROUP)	MARKET VALUE	SALES	PROFITS
84	Sempra Energy SRE (24)	278	202	146
167	Sherwin-Williams SHW (5)	356	262	295
494	Siebel Systems SEBL (19)	416	462	425
248	Sigma-Aldrich SIAL (22)	422	458	368
300	Simon Property Group SPG (13)	200	380	312
181	SLM SLM (11)	120	327	67
388	Snap-on SNA (2)	482	397	438
452	Soletron SLR (21)	397	159	476
263	Southern SO (24)	101	155	87
420	Southwest Airlines LUV (18)	240	257	331
323	Sovereign Bancorp SOV (10)	310	381	259
301	Sprint FON (23)	72	65	490
91	St. Jude Medical STJ (14)	197	403	281
264	St. Paul Travelers STA (12)	94	78	140
235	Stanley Works SWK (2)	432	366	361
61	Staples SPLS (5)	167	124	187
33	Starbucks SBUX (3)	119	277	273
162	Starwood Hotels & Resorts HOT (3)	226	285	308
399	State Street STT (11)	185	269	166
121	Stryker SYK (14)	128	329	255
466	Sun Microsystems SUNW (21)	189	166	473
230	SunGard Data Systems SDS (19)	322	349	258
18	Sunoco SUN (9)	331	76	207
344	SunTrust Banks STI (10)	92	228	86
210	Supervalu SVU (6)	418	93	297
32	Symantec SYMC (19)	170	395	233
312	Symbol Technologies SBL (21)	420	438	437
341	Synovus Financial SNV (10)	296	382	268
199	Sysco SYV (6)	113	57	142

T,U

201	Target TGT (5)	59	28	68
488	Teco Energy TE (24)	450	384	482
416	Tektronix TEK (21)	468	477	427
477	Tellabs TLAB (21)	447	470	472
360	Temple-Inland TIN (22)	409	309	402
INC	Tenet Healthcare THC (14)	384	186	493
412	Teradyne TER (20)	453	433	401
139	Texas Instruments TXN (20)	58	143	70
288	Textron TXT (16)	256	179	306
286	Thermo Electron TMO (14)	414	407	373
52	3M MMM (16)	35	92	43
284	Tiffany TIF (5)	413	408	335
355	Time Warner TWX (4)	26	30	38
182	TJX TJX (5)	230	120	197
332	Torchmark TMK (12)	371	364	252
383	Toys 'R' Us TOY (5)	394	165	412
315	Transocean RIG (9)	169	387	411
387	Tribune TRB (4)	211	272	217
401	TXU TXU (24)	110	206	439

RANK	COMPANY	OTHER RANKINGS		
	SYMBOL (INDUSTRY GROUP)	MARKET VALUE	SALES	PROFITS
180	Tyco International TYC (16)	33	32	4
197	U.S. Bancorp USB (10)	46	121	2
419	Union Pacific UNP (18)	159	151	2
482	Unisys UIS (19)	467	270	4
103	United Parcel Service UPS (18)	23	42	7
37	United States Steel X (22)	333	130	12
73	United Technologies UTX (16)	52	39	4
5	UnitedHealth Group UNH (14)	42	40	5
247	Univision Communications UVN (4)	293	435	35
44	Unocal UCL (9)	192	227	12
441	UnumProvident UNM (12)	390	178	47
225	UST UST (7)	286	431	23

V,W

4	Valero Energy VLO (9)	142	20	78
278	Veritas Software VRTS (19)	262	417	28
154	Verizon Communications VZ (23)	19	14	1
132	VF VFC (2)	350	267	25
436	Viacom VIA.B (4)	40	81	48
473	Visteon VC (1)	498	103	49
368	Vulcan Materials VMC (22)	368	394	35
88	Wachovia WB (10)	24	64	20
77	Walgreen WAG (6)	61	36	96
209	Wal-Mart Stores WMT (6)	5	1	8
391	Washington Mutual WM (10)	69	111	52
275	Waste Management WMI (17)	158	145	145
158	Waters WAT (14)	369	475	36
411	Watson Pharmaceuticals WPI (15)	440	446	413
35	WellPoint WLP (14)	156	85	13
159	Wells Fargo WFC (10)	18	50	16
414	Wendy's International WEN (3)	417	345	44
104	Weyerhaeuser WY (22)	162	80	106
270	Whirlpool WHR (2)	419	138	283
362	Williams WMB (9)	255	147	433
133	Wrigley (Wm.) Jr. WWY (7)	179	344	245
367	Wyeth WYE (15)	47	108	114

X,Y,Z

435	Xcel Energy XEL (24)	336	218	237
238	Xerox XRX (21)	182	113	170
189	Xilinx XLNX (20)	254	450	304
75	XL Capital XL (12)	257	187	120
41	XTO Energy XTO (9)	227	422	241
8	Yahoo YHOO (19)	64	348	160
141	YUM! Brands YUM (3)	194	211	178
38	Zimmer Holdings ZMH (14)	118	370	230
382	Zions Bancorporation ZION (10)	367	423	284

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BY GENE G. MARCIAL

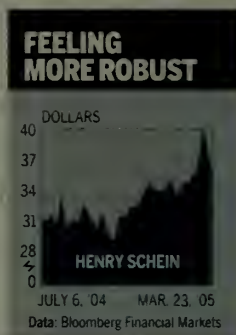
THE VACCINE WOES ARE CLEARING UP FAST AT **HENRY SCHEIN.**

WHY **MARITRANS'** SHIPPING FLEET HAS NO SHORTAGE OF CARGO

BANKING IS SHOWING BRIGHT PROMISE AT **E*TRADE FINANCIAL.**

Schein Gets Over the Flu

WHEN BRITAIN ORDERED CHIRON to halt output of its influenza vaccine last October, one company that got clobbered was Henry Schein (HSIC), the world's top distributor of health-care goods—and No. 1 in flu vaccines in the U.S. Schein supplies medicines and services to 400,000 doctors, dentists, and vets. Chiron's woes shaved 50¢ a share off Schein's fourth-quarter earnings. Its stock—at 40 last April—swooned to 28.80 by Oct. 19. But Schein has rallied, to 40 on Mar. 7, before easing to 36. “Fourth-quarter earnings were impressive, as other products [especially dental] continued to grow rapidly,” says John Maloney, president of M&R Capital Management, which owns shares. The flu issue is almost resolved. On Mar. 2, Britain lifted the Chiron suspension. The Food & Drug Administration is expected to follow suit by summer, says Maloney. He notes Schein has asked other makers—Sanofi-Aventis, ID Biomedical, MedImmune, and GlaxoSmithKline—for vaccines in 2005 and 2006. Suey Wong of securities firm Robert W. Baird, which has done banking for Schein, sees profits of \$2.03 a share on sales of \$4.8 billion in 2005, and \$2.31 on \$5.2 billion in 2006, vs. 2004's \$1.53. Wong rates Schein “outperform,” with a target of 46. He sees it as one of 2005's best performers.



Smooth Sailing for Maritrans' Tankers and Tugs

MARITRANS (TUG) has the wind at its back: A U.S. operator of tugs, tank barges, and oil tankers, it benefits from the Jones Act, which restricts point-to-point maritime shipping within U.S. waters to vessels that are U.S.-owned, -built, and have an American crew. What's more, the Oil Pollution Act of 1990 mandates that tankers must be double-hulled by the end of 2005. Natasha Boyden of investment firm Cantor Fitzgerald, who rates the stock, now at 18.10, a strong buy with a target of 24, says 33% of U.S. oil carriers will have to be scrapped by 2007. The high barriers to entry in the industry—lofty steel prices, the Jones Act, and the high cost of new vessels—means capacity will be constricted, she says. Maritrans, which has been converting its vessels into double hulls, will profit from the coming shortage, says

Boyden. Maritrans ships from refineries in the Gulf of Mexico to Atlantic terminals, mainly in Florida, where it has a 20% share. It also does “lightering”—unloading crude from large tankers (which can't ply shallow waters) into small vessels for delivery to ports in Delaware and other Eastern states. She expects Maritrans to earn \$1.06 a share in 2005 and \$1.35 in 2006. Brad Osleger, of investment outfit Deprince, Race & Zollo, which owns shares, says that by yearend 70% of its vessels will be double-hulled, as it continues to rebuild the rest.



Ballooning Bank Deposits At E*Trade

WATCH THE MONEY, not the stock trading at E*Trade Financial (ET). Shares of E*Trade, a provider of online brokerage and banking services, have languished around 12 this year, because investors have been disappointed at weak trading and stiff competition. “But investors should focus on its banking, which is growing fast,” says Ed Hemmelgarn of Shaker Investments, which owns shares. In two years, banking revenues have surpassed broker fees, he notes. Campbell Chaney of investment firm Sanders Morris Harris, who rates the stock a strong buy, says key factors are the assets and deposits in client accounts, which totaled \$97 billion in February, up 2% from \$95.2 billion in January. E*Trade's new business model depends less on brokerage, he notes. It is able to “sweep client assets from the broker to the bank,” he says. Its “Optimizer” plan advises clients on maximizing gain from investments. Mortgage and home-equity lending have been on a tear. Home-equity loans jumped 33% from January to February. Chaney forecasts net of \$1 in 2005 and \$1.15 in 2006, up from 2004's 94¢. He sees E*Trade at 20 in a year. ■



BusinessWeek online Gene Marcial's Inside Wall Street is posted at businessweek.com/today.htm at 5 p.m. EST on the magazine's publication day, usually Thursdays.

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Restructuring

Natural Gas & Electricity Markets

After a three-year lull in deregulation efforts, natural gas and electric markets are moving toward a competitive market-based model. Many state regulators and utilities have determined that the benefits of separating the commodity sale from the delivery function are healthier for both consumers and energy market participants. Regulated utilities are focusing on delivering dependable natural gas and electric services, while unregulated energy retailers are performing the merchant and commodity risk management functions.

Progressive States are Leading the Way

There are measurable signs that energy deregulation invigorates economies in states that encourage customer choice. Over 50 new retail marketers have registered to do business in New York as a result of well-engineered restructuring policies announced by the New York Public Services Commission. New York's innovative restructuring policy encourages utilities to offer consolidated billing services and in turn encourages deregulated energy retailers to offer lower rates to consumers who shop for energy. "New York is an impressive display of progressive, market-based policy making," according to Craig Goodman, President of the National Energy Marketers Association (NEMA). "Utilities are rewarded for enhanced reliability and retail marketers can avoid needless duplication of costs, passing along these savings to the consumers."

When states set smart rules in place, technology companies respond. Pat McParlane, Siemens Building Technologies, agrees and says that, "Siemens works closely with the New York State Energy Research and Development Authority to secure

funds that help create energy-reducing programs for customers in a number of innovative projects around the state."

The Texas electricity and Georgia gas market models serve as excellent examples of win-win deregulation, and even California is revisiting the benefits of reopening its electricity markets. Joe Desmond, Deputy Secretary of Energy for the State of California, reports that "Governor Schwarzenegger called for an open, transparent, competitive procurement process for energy. The new rules adopted in December by the Public Utilities Commission ensure the best possible deal for consumers in terms of price, risk, reliability and environmental impact."

Regulated Utilities Thrive with Restructuring

Utilities benefit from restructuring by reallocating capital, credit and resources that are currently utilized in commodity markets and back office overhead. The public is better served if these funds are invested in delivery infrastructure to improve reliability.

Atlanta Gas Light (AGL) exited the regulated merchant business in late 1999, allowing it to focus resources on expanding its investments in delivery and service infrastructure and unregulated wholesale and retail commodity marketing. As a result, AGL has enjoyed a steady growth in stock price of about 20% per year since restructuring began. The retail marketers were also winners in Georgia, with access to over a million new customers.

TXU, a Texas utility, implemented a bold business model in the restructured energy market environment. TXU outsourced high-cost internal operating units and shed non-core assets, which freed up approximately \$3.5 billion that TXU used to repurchase its stock. Last year TXU stock nearly tripled, rising from \$27 to \$79. According to NEMA's Craig Goodman, "TXU is an excellent illustration of how a deregulated environment

We are.

Global network of innovation

[illegible]

Defining the Market.



Peter Weigand
President
Commerce Energy Group

Commerce Energy Group, (AMEX:EGR) is an unregulated energy marketer providing natural gas and electricity to homeowners, small and large businesses, government and institutional facilities and retail chains. The company also provides consulting and outsourced energy transaction services to utilities, energy merchants and asset owners.

Founded in 1998 as a retail electricity marketer in California, Commerce Energy has grown to serve 17 utility markets in nine states with both electricity and natural gas. Growth had been fueled by a combination of organic means and acquisitions. In the past 12 months the company acquired Skipping Stone, an energy consulting company, and ACN Energy, a mass market energy retailer of electricity and natural gas.

According to an independent report, Commerce Energy is the largest non utility-owned retail marketer of energy in the United States.

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Defining the Market

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inspires creativity and conclusively demonstrates that restructuring provides substantial benefits to utilities, shareholders and consumers."

Retail Marketers Poised for Growth

With renewed growth in restructured natural gas and electric markets, retail marketers are reaping the benefits of customers switching from their host utilities. One such retail marketer, Commerce Energy Group, has positioned itself for growth by becoming publicly traded, (AMEX: EGR) and acquiring ACN Energy. Founded in 1997 as a retail electric provider in California, the company has since expanded to 9 states and 17 utility markets offering both electric and natural gas. "The growth potential in retail electric and gas markets is unparalleled in any other industry I can think of," says Peter Weigand, Commerce Energy Group President. "With our strong balance sheet, access to public equity, and superior systems and people, I like our position in the market very much," continues Weigand. Commerce Energy Group investors seem to concur, as their stock has risen 78% since the beginning of this year.

Technology in the Energy Sector is Booming

A natural incubator for technological innovation is created by the system needs of new retail marketing customers, and the infrastructure needs of utilities for system reliability to address population growth, economic expansion, and market restructuring.

The comprehensive energy legislation currently before the Congress contains a number of provisions that are designed to strengthen and diversify our energy supply and distribution system. Randy Zwirn, president and CEO, Siemens Westinghouse, explains that, "as a result, we expect the industry to develop ways to increase access to gas through the strategic siting of LNG terminals, introduce the next generation of clean coal technologies, continue to extend nuclear licenses and modernize nuclear power plants, and increase our use of renewables in the production of

electricity." The ability to utilize a variety of fuels in our production of electricity will help mitigate the extreme price spikes we've experienced during the past several years.

As for power grid reliability, David Pacyna, CEO of Siemens Power Transmission & Distribution, reports that "depreciation incentives are already passed, but two remaining points, standards and siting authority, would complete the package of stimuli needed to get investment in the grid moving. The even bigger picture is that the industry should become free to remodel itself to drive out cost inefficiencies while maintaining/improving the reliability and performance of the network."

US industry as well as individual energy consumers expect a reliable energy supply at reasonable prices. Zwirn believes, "that the energy legislation currently before the Congress will help meet that expectation. And while we can't expect to achieve wholesale change overnight, it's imperative that we start now so that in future years, our economy will be driven by a clean, reliable and cost-efficient supply of electricity."

With more state regulators converting to the benefits of restructuring and the technology sector responding with new and innovative solutions, the results bode well for energy market participants, shareholders, and most importantly, consumers.

WEB DIRECTORY

Siemens
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Commerce Energy Group
www.commerceenergy.com

Writer: Verna Ray is Principal of the Marketing and Communications practice at Skipping Stone, an energy consulting company founded in 1996 by leaders from within the energy industry.

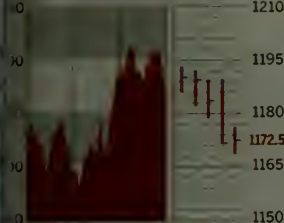
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OCKS

S&P 500

MAR. SEPT. MAR. MAR. 17-23



COMMENTARY

ationary signals, long evident consumers, finally got the Fed's ention, resulting in a hawkish tement on top of an expected arter-point rate hike. Treasuries ooned, though the shock all ar has been their resilience. ocks bore up well, considering. t with the energy sector cking profits from the rest of the onomy, it's hard to see equities lying anytime soon.

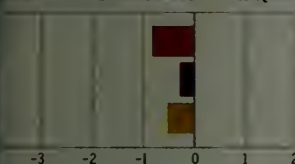
Source: Bloomberg Financial Markets, Reuters

MUTUAL FUNDS

4-WEEK TOTAL RETURN

WEEK ENDED MAR. 22

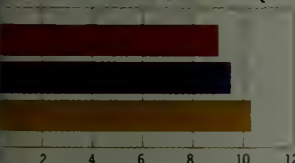
■ S&P 500 ■ U.S. DIVERSIFIED ■ ALL EQUITY



2-WEEK TOTAL RETURN

WEEK ENDED MAR. 22

■ S&P 500 ■ U.S. DIVERSIFIED ■ ALL EQUITY



Source: Standard & Poor's

U.S. MARKETS

	MAR. 23	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	1172.5	-1.3	-3.3	7.2
Dow Jones Industrials	10,456.0	-1.7	-3.0	3.9
NASDAQ Composite	1990.2	-1.3	-8.5	4.6
S&P MidCap 400	654.2	-1.6	-1.4	12.6
S&P SmallCap 600	319.8	-1.8	-2.7	16.7
DJ Wilshire 5000	11,557.8	-1.3	-3.3	8.1

SECTORS

	MAR. 23	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
BusinessWeek 50*	696.2	-1.7	-1.2	14.0
BW Info Tech 100**	348.4	-1.4	-6.7	3.7
S&P/BARRA Growth	566.7	-0.7	-2.6	5.5
S&P/BARRA Value	601.5	-1.9	-3.8	8.8
S&P Energy	334.5	-0.9	15.9	45.4
S&P Financials	379.9	-3.5	-7.6	-2.4
S&P REIT	131.1	-2.5	-9.2	3.3
S&P Transportation	225.4	-0.1	-6.7	21.9
S&P Utilities	144.3	-2.4	1.9	19.0
GSTI Internet	152.7	-0.5	-14.4	13.7
PSE Technology	726.3	-0.4	-6.8	6.7

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS

	MAR. 23	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	1404.9	-3.0	-1.3	20.1
London (FT-SE 100)	4910.4	-0.6	2.0	13.7
Paris (CAC 40)	4032.4	0.3	5.5	13.9
Frankfurt (DAX)	4317.2	0.2	1.4	15.8
Tokyo (NIKKEI 225)	11,739.1	-1.1	2.2	3.3
Hong Kong (Hang Seng)	13,603.6	-1.7	-4.4	7.3
Toronto (S&P/TSX Composite)	9549.7	-1.7	3.3	12.7
Mexico City (IPC)	12,852.8	-1.9	-0.5	27.8

FUNDAMENTALS

	MAR. 22	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	2.03%	1.99%	1.63%
S&P 500 P/E Ratio (Trailing 12 mos.)	19.6	20.0	21.9
S&P 500 P/E Ratio (Next 12 mos.)*	15.8	16.1	17.4
First Call Earnings Revision*	0.50%	0.67%	1.51%

*First Call Corp.

TECHNICAL INDICATORS

	MAR. 22	WEEK AGO	READING
S&P 500 200-day average	1150.1	1148.5	Positive
Stocks above 200-day average	65.0%	73.0%	Neutral
Options: Put/call ratio	0.89	0.80	Positive
Insiders: Vickers NYSE Sell/buy ratio	4.84	4.81	Negative

BEST-PERFORMING GROUPS

	LAST MONTH %	LAST 12 MONTHS %
Drug Chains	10.5	Fertilizers & Ag. Chems. 74.7
Railroads	10.2	Oil & Gas Refining 71.8
Distillers & Vintners	8.5	Steel 71.4
Department Stores	7.1	Oil & Gas Exploration 56.7
Health-Care Facilities	6.9	Railroads 51.9

WORST-PERFORMING GROUPS

	LAST MONTH %	LAST 12 MONTHS %
Automobiles	-17.9	IT Consulting -50.3
Multi-line Insurers	-15.1	Insurance Brokers -29.9
Internet Retail	-14.0	Automobiles -26.0
Auto Parts & Equipment	-13.5	Auto Parts & Equipment -21.9
Home Entertainment	-13.4	Casinos -18.8

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Natural Resources	2.7	Natural Resources	44.2
Japan	2.1	Latin America	37.3
Utilities	1.1	Europe	25.1
Diversified Pacific/Asia	1.0	Utilities	22.9
LAGGARDS		LAGGARDS	
Latin America	-4.7	Precious Metals	-3.1
Precious Metals	-3.3	Technology	-2.1
Technology	-2.9	Health	2.0
Diversified Emerg. Mkts.	-2.7	Financial	4.0

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Oppenheimer RI. Asst. A	8.8	ProFunds Oil & Gas Inv.	78.4
iShares Dow Jones Transp.	5.8	BlackRock Gl. Res. Inv. A	65.5
ProFunds Ultra Japan Inv.	5.1	U.S. Gbl. Invs. Gl. Rscs.	55.1
BlackRock Gl. Res. Inv. A	4.7	iShares MSCI Austria Idx.	54.6
LAGGARDS		LAGGARDS	
American Heritage Growth	-14.3	Ameritor Investment	-50.0
Ameritor Investment	-11.1	Apex Mid Cap Growth	-28.6
PIMCO RCM Biotech. D	-10.3	ProFds. Ush. Mid Cap Inv.	-26.4
Kopp Emerging Growth A	-8.1	ProFunds Semicdr. Inv.	-24.8

INTEREST RATES

KEY RATES

	MAR. 23	WEEK AGO	YEAR AGO
Money Market Funds	2.21%	2.15%	0.58%
90-Day Treasury Bills	2.81	2.79	0.94
2-Year Treasury Notes	3.82	3.70	1.45
10-Year Treasury Notes	4.59	4.51	3.71
30-Year Treasury Bonds	4.85	4.79	4.66
30-Year Fixed Mortgage †	6.05	5.93	5.38

†BanxQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
General Obligations	3.85%	4.58%
Taxable Equivalent	5.50	6.54
Insured Revenue Bonds	3.96	4.67
Taxable Equivalent	5.66	6.67

THE WEEK AHEAD

CONSUMER CONFIDENCE

Wednesday, Mar. 29, 10 a.m. EST » The Conference Board's March consumer confidence index is expected to have slipped a notch, to 103. That's the median precast of economists polled by Action Economics. In February, the index eased to 104.

PERSONAL INCOME Thursday,

Mar. 31, 8:30 a.m. EST » February personal income most likely grew 0.5%, after a 2.3% fall

in January. A Microsoft dividend payout in December is the reason for the January drop. Exclude the dividend, and income rose 0.5% in January. Consumer expenditures probably rose 0.5%, after holding steady in January.

EMPLOYMENT Friday, Apr. 1,

8:30 a.m. EST » Nonfarm payrolls are forecast to have increased by 225,000 in March, after a better-than-expected increase of 262,000 in February.

The March jobless rate probably declined to 5.3%, from 5.4%.

FACTORY INVENTORIES

Thursday, Mar. 31, 10 a.m. EST » Manufacturing inventories probably rose 0.5% in February. In January inventories jumped 1.3%.

PURCHASING MANAGERS' INDEX

Friday, Apr. 1, 10 a.m. EST » The Institute for Supply Management's factory activity index likely edged down to 55% in March, after falling to 55.3%.

The BusinessWeek production index climbed to 238.7 for the week ended Mar. 12, an 11.3% increase from a year ago. Before calculation of the four-week moving average, the index slipped to 238.9.

BusinessWeek online

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/magazine/extra.htm

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BusinessWeek (ISSN 0007-7135) Issue number 3927, published weekly, except for one week in January and one in August, by Time Warner Entertainment Company, L.P., Executive, Editorial, Circulation, and Advertising Offices: 1221 Avenue of the Americas, New York, N.Y. 10020. Periodicals postage paid at New York, N.Y., and at additional mailing offices. Canada Post Publication Mail Agreement Number 40012501. Return undeliverable Canadian addresses to: DPGM Ltd., 4960-2 Walker Road Windsor, ON N9E 6J3. Email: bwcustomerservice@needata.com
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MGM v. Grokster: A Chance to Foster Innovation—and Fight Piracy

A ROUGH WAY to measure the importance of Supreme Court cases is to tally the number of “friend-of-the-court” briefs filed by people, companies, and organizations with no direct stake in the underlying legal battle. In what appears to be a new record for a business dispute, 55 amicus briefs have been submitted in *Metro-Goldwyn-Mayer*

v. Grokster, which is scheduled to be argued on Mar. 29. The movie studio’s supporters include the National Football League, Nobel prizewinning economists Kenneth J. Arrow and Gary S. Becker, the Christian Coalition, and the surviving members of the rock band the Grateful Dead. This once-in-a-lifetime policy confederation is squared off against AT&T, Intel, the American Civil Liberties Union, the American Conservative Union, and a platoon of computer science professors, among many others.

The issue that has sparked all this outside interest is whether the peer-to-peer Web site Grokster owes money to the entertainment industry for copyright violations committed by its users. This is just one skirmish in a greater conflict—the escalating war between content creators and content distributors—that will shape the future of a big swatch of American business. The high court’s resolution of *MGM v. Grokster* has the potential to determine winners and losers in the music, movie, consumer-electronics, telecommunications, e-commerce, computer hardware, and software industries. Striking the correct balance between the various public and private interests in this case will require some creative thinking.

POWERFUL PRECEDENT. Hollywood and the recording industry have lost the early rounds. In August, a federal appeals court sided with Grokster. The decision was based on the Supreme Court’s landmark 1984 ruling *Sony v. Universal City Studios*, commonly known as the Betamax case. It basically held that producers of technology that can be utilized to illegally copy creative works cannot be held liable if the same technology has “substantial” legal uses. This precedent paved the way for the proliferation of e-mail, iPods, TiVo, and other products that, while generally beneficial, have increased the traffic in illegally copied movies, songs, and software.

But the tide may be about to turn. The fact that the justices

have granted an audience to MGM and 27 other entertainment companies is a strong indication that they are reconsidering the wisdom of the Betamax decision. The petitioners are asking the Supreme Court to create a new rule that would essentially outlaw peer-to-peer Web sites, portable music players, and other products if the majority of customers are using them illegally. That may sound like a reasonable position, but it would thwart innovation. The next generation of imaginative digital products and services would face far more risk of expensive litigation—decreasing the incentive for entrepreneurs, venture capitalists, and executives to take the risk of investing in them.

PROMISING SUGGESTIONS. That’s why the Supreme Court needs to preserve the essence of the Betamax ruling: a wide safe harbor for innovative new technology, even if it contains some potential for abuse by copyright pirates. But it would be a mistake for the justices simply to reaffirm their old logic. The Betamax case essentially has offered the Groksters of the world a free pass. They rake in profits from piracy while disingenuously pontificating about the virtue of sharing. Arrow, Becker, and eight other prominent economists have it right in their

The high court must devise a rule that deters copyright infringement

thoughtful joint brief when they argue that the *Sony* precedent “gives manufacturers no incentive to deter infringement even when deterrence could be accomplished at a low cost.”

This state of affairs needs to be changed. The court’s goal should be to devise a rule that encourages the introduction of exciting new products while discouraging easily preventable robbery. That’s no simple task.

But the good news is that the towering pile of amicus briefs in *Grokster* actually contains some promising suggestions. One is punishing companies that actively encourage copyright infringement—for instance those that highlight the ease of intellectual-property theft in marketing campaigns, show users how to do it, and help them cover their tracks. Briefs submitted by the Business Software Alliance, the American Intellectual Property Law Assn., and others offer several variations on this approach. Another idea is placing an obligation on tech execs to police piracy—say, by installing software that helps to prevent it. Both of these middle-ground legal standards are fair compromises that would balance the competing values in this case: property rights vs. free speech, artistic creativity vs. technological innovation.



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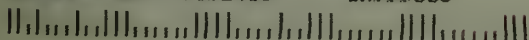
AFTER THE HOUSING BOOM

What the coming slowdown
means for the economy—and you.

BY KATHLEEN MADIGAN (P.78)



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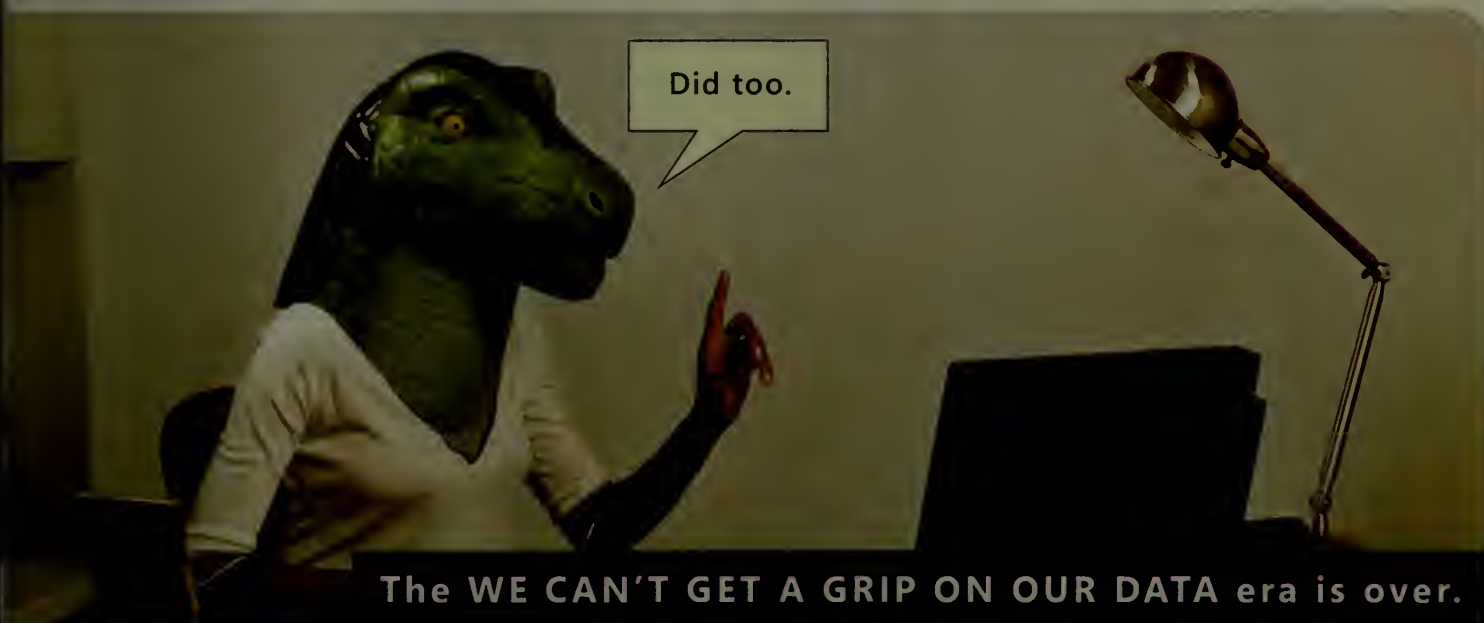
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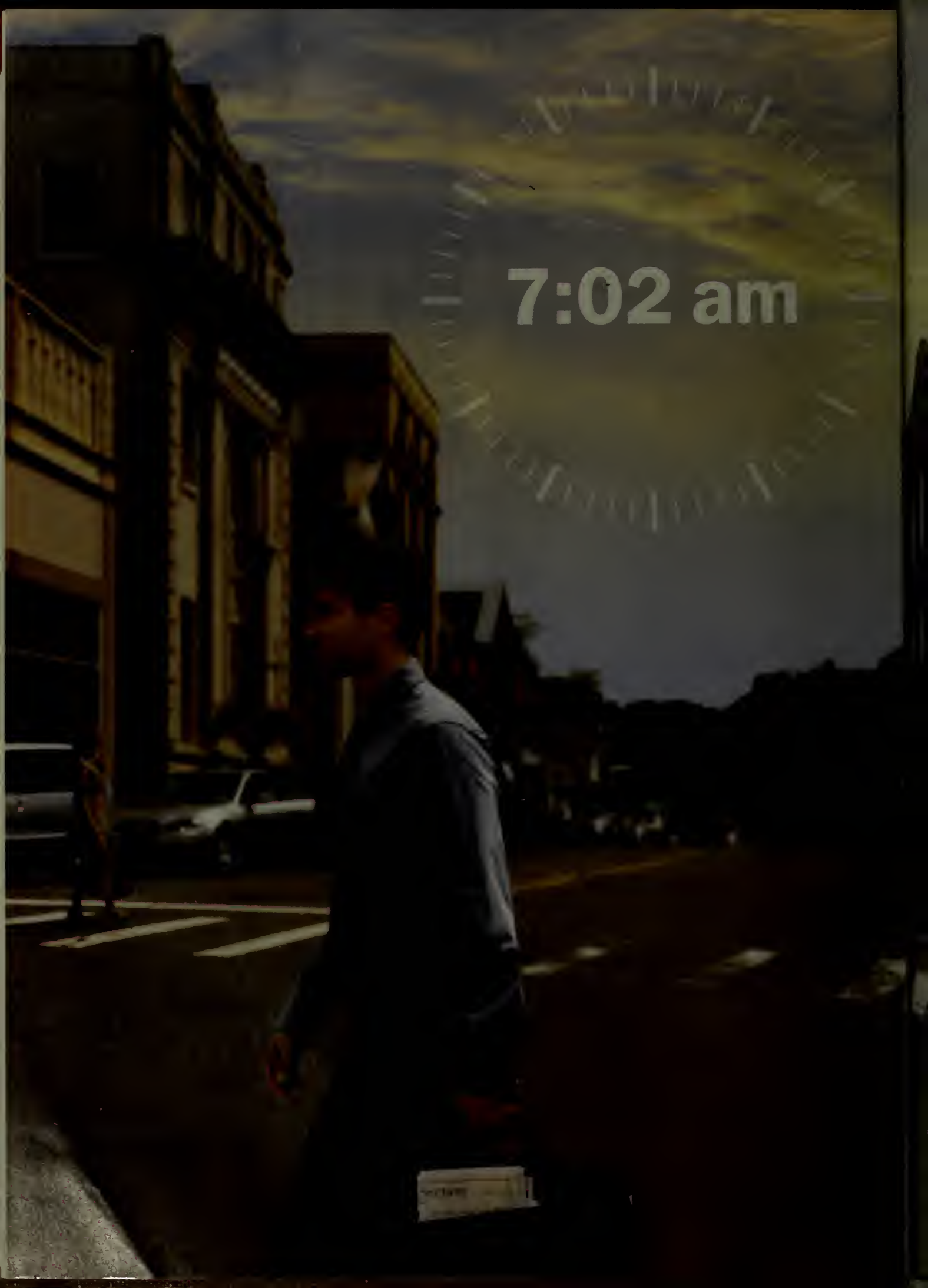
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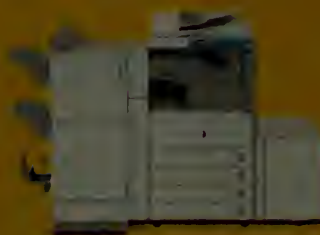


A photograph of a man walking on a city street at dawn. The man is in the foreground, walking from left to right, wearing a light-colored shirt and dark pants. He is carrying a newspaper under his arm. The street is lined with multi-story buildings on the left. In the background, there are more buildings and a few cars parked along the street. The sky is a mix of blue and orange, suggesting the time is early morning. A large, semi-transparent clock face is overlaid on the right side of the image, with the time 7:02 am displayed in the center. The clock face is white with black numbers and hands, and it is slightly tilted. The overall mood is quiet and early in the day.

7:02 am



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A LOWER ROOF

With rising interest rates gnawing away at home buyers' purchasing power, the days of dramatic price leaps are over

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Bill Gates: The PC Era Is Just Beginning

Although critics claim the desktop is passé, Microsoft's chairman argues in a guest column that its greatest potential and that of other computing devices is still ahead



Women in the Workplace: Glass Ceilings and Iron Girders

Despite the good work celebrated at advocacy group Catalyst's annual award dinner, the fact remains that few females hold top-tier jobs. Plus: A Q&A with Xerox CEO Anne Mulcahy



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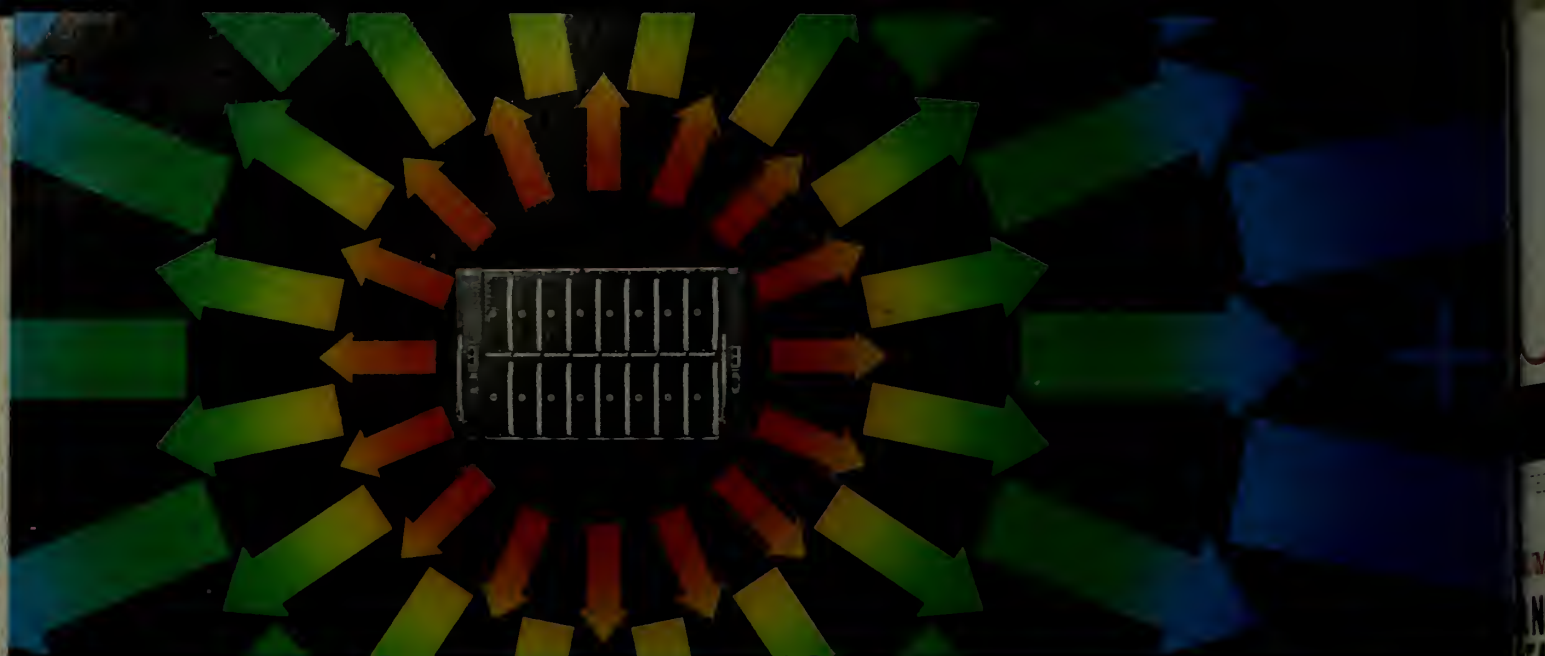
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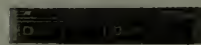
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JP Front

"Many film stars have revealed their secret desire to broadcast the weather."

—Terry Connelly, senior vice-president for The Weather Channel, in a statement announcing celebrity guest forecasters

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TUMBER CRUNCH A NEW LEASE ON ACCOUNTING

IN THE LATE 1990s, accounting analyst Jack Ciesielski kept a running tally of the charges companies were taking to cleanse their earnings of "one-time" costs. Today he is tracking something new: lease restatements. So far the publisher of *The Analyst's Accounting Observer*, has found 206 retailers, restaurants, and cellular service providers that are changing how they account for leases. The companies seem to have stretched out rent expenses that should have been accounted for sooner. The restatements at companies including **Cingular Wireless**, **Bohl's**, and **McDonald's** follow an SEC letter reiterating the long-standing rules.



The effect on earnings is modest compared to the shenanigans of the 1990s—generally pennies per share. Ciesielski sees this round not as an attempt to puff up profits but as a step toward accurate earnings. Now that's progress. —Nanette Byrnes



WRETCHED EXCESS

Payback Delayed

IT DIDN'T TAKE very long for \$2 trillion in shareholder wealth to vanish after the dot-com bubble burst. But it's taking far longer for investors to see restitution for the misdeeds at companies such as **WorldCom**, **Enron**, **Tyco**, a scad of investment banks, and several mutual-fund companies that helped to erode confidence in the markets. Public agents such as the **SEC** and New York Attorney General Eliot Spitzer have wrangled huge settlements, meant to return at least some of investors' cash.

So where's your check? Tied up in red tape, probably. Since 2002, the SEC has set up 55 investor claims funds, holding a total of \$4.5 billion. But only 1.3%, \$60 million, of that has flowed to investors. The process is set up to be slow: Distributions must be

approved by a court, which must approve a distribution agent, which must identify shareholders, who must file claims, and so on. It could take three years in large cases. Payouts from private secur-

KEN LAY May lose "ill-gotten gains"

ities class actions have been quicker. From 2001 to

2004, the biggest 100 cases yielded \$14.7 billion in settlements. Much of that has been paid out, says Institutional Shareholder Services. As of Mar. 18, there's \$7.2 billion more—including new WorldCom money—in the pipeline.

Burned investors can also target the personal fortunes of CEOs. The SEC wants more than \$90 million from Kenneth L. Lay in "ill-gotten gains" from his sale of Enron stock. Tyco's Dennis Kozlowski and Mark Swartz, on trial for a second time, have had \$600 million in assets frozen. Money gained from the forfeited property will go to a restitution fund for victims. Others, like ex-WorldCom CEO Bernie Ebbers, may face prison time. Some investors will just have to be satisfied with old-fashioned revenge.

—Mara Der Hovanesian, Amy Borrus, and Karen Donovan

ON THE HOOK? Several executives may lose their personal fortunes to repay burned investors.



JOHN J. RIGAS (above) and Timothy, the father/son team from Adelphia Communications, may have to pay out \$2.53 billion.



RICHARD SCRUSHY, the former CEO of HealthSouth may face a potential personal payout of \$278 million.



L. DENNIS KOZLOWSKI (above) and Mark Swartz, have had \$600 million in assets frozen.

Data: BusinessWeek

CAR TALK

AN SUV FOR THE SUSHI SET

SUBARU OF AMERICA'S all-wheel-drive station wagons and hatchbacks have long appealed to pragmatic consumers known for gushing about the cars'



B9 TRIBECA

Subaru's pricey SUV

ability to guide them unscathed through

snowstorms and washed-out roads—so much so that the company is a longtime sponsor of **The Weather Channel**. So it's a bit surprising that not only has the company waited until this June to launch its first legitimate sport-utility vehicle—the last auto maker to do so—but that Subaru is pricing it above \$35,000. That's out of reach for many of the frugal-minded Snow Belt letter carriers and New England schoolteachers who relished Subaru's long-running 1980s ad slogan, "Inexpensive, and built to stay that way."

Brands that reach upward in price and prestige usually feel the pull of gravity—Volkswagen, for instance, has stumbled badly with high-priced sedans. But Subaru parent **Fuji Heavy Industries Ltd.** feels it has no choice but to move its brand to a ritzier part of town. Unlike most other Japanese carmakers, Fuji

lost money in the U.S. last year, as U.S., German, and Asian rivals have threatened Subaru's niche with their own versions of all-wheel-drive vehicles.

The sporty new B9 Tribeca is named for a high-rent Manhattan neighborhood known for sushi bars. To show off the Tribeca, Subaru last week began a national tour where it's displaying the SUV at tony venues like the Houston Museum of Art and Phoenix' Biltmore Fashion Park/Urban Village. The goal, says Lee Garfinkel, chief creative

officer of **DDB Needham**, Subaru's new ad agency, is to "make it O.K. for someone to drive a Subaru up to a Broadway show or club."

—David Kiley

GRAPE IDEAS

SLIGHT WINE Ladies, if you've gone off light beer, try low-calorie wine. On Apr. 4, Beringer Blass Wine Estates, part of Foster's Group, plans to unveil White Lie Early Season Chardonnay. At \$10 a bottle, it has 25% fewer calories and 32% less alcohol than regular Chardonnay. In the '80s, several low-cal wines flopped because they tasted watered-down. White Lie is made from grapes picked early, containing less sugar. The label features prevarications women are said to tell, such as "always get up early to exercise." Patronizing? Sure. Still, guilt-free wine could appeal to weight-conscious men, too.

—Louise Le



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BRAD SMITH



GIVING TAX TIME A HIP-HOP SPIN

Brad Smith is in the market for some street cred. As the head of Intuit's consumer-tax division, he manages one of the best-known brands in software. But sales growth of the popular TurboTax program is slowing—from a 29% increase in 2002 to an expected 5% to 10% this year.

This tax season, Smith, 41, is trying a new tack: making the staid brand hip. In an effort to appeal to first-time filers, Smith brought in 18-to-24-year-olds to find out what makes them tick. The answer: It's not ads. "You can advertise, but they will TiVo it out," Smith says. "You can e-mail them, but they'll stop it as spam."

So he's offering them discount cards usable at BestBuy and Expedia.com to make their tax refunds go further. The Gen Yers also helped design a new portal for young tax filers, with the MTV-esque name "Rock Your Refund." And since Smith isn't exactly P. Diddy, he signed up hip-hop impresario Russell Simmons to promote tax-filing as cool. What's next, a music video? —Sarah Lacy

SPORTS BIZ

A BIRDIE FOR FAMILY VALUES

WHEN PHIL MICKELSON swats his first tee shot at the Masters Tournament on Apr. 6, his caddie won't be much taller than a leprechaun. For the annual par-3 tourney, a prelim to the main event, he has lined up his 5-year-old daughter, Amanda, who presumably will be paid for her club-toting services in Gummi Bears. It's fitting, since Mickelson, 34, has done more than any other golfer to burnish his image as a family guy—and it's bringing in the bucks. At more than \$20 million a year in endorsements, some sports marketers say he's the second-highest paid U.S. athlete in off-field earnings.

Though rival Tiger Woods tops that leaderboard at about \$80 million, Mickelson gets deals that would be out of bounds for Woods, who doesn't have children, or Vijay Singh, who keeps his private life strictly private. Rolex, Bearing Point, and Callaway Golf have all



WINNING SMILE Mickelson with Sophia, 3

tapped Mickelson. Ford Motor Co. pays

him about \$7 million a year. And the cars in the Mickelson garage are Ford Expeditions, because, Phil claims, they're safe for transporting the kids—Amanda, Sophia, 3, and Evan, 2.

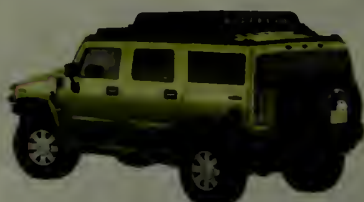
Skeptics question the Mickelson image. Last month, when Singh was asked on HBO's *Real Sports* with Bryant Gumbel if he envied Mickelson's endorsement deals and family-man persona, he

replied: "Yeah. But is that the true Phil?" Says Mickelson: "I have good relations with everyone in the golf industry or try to."

Even Mickelson's new memoir—*One Magical Sunday*, which sold for more than \$500,000, sources say—is a bouquet to his family. Full-page ads for it feature photos of him with his dad and with wife Amy. Mickelson took home \$5.7 million in prize money for his golfing last year. But family values are proving more valuable to the lucky lefty. —Mark Hyma

ROAD RAGE

CASH GUZZLERS Since 2000 the average cost of a gallon of self-serve gasoline shot up 39%, from \$1.51 to \$2.10. With record-breaking oil prices and expected seasonal summer price hikes, experts see no relief in sight. Based on city mileage ratings, here's how much more you'll pay to drive 10,000 miles than you did five years ago.



H2 HUMMER* / 12 MPG

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\$281



TOYOTA PRIUS / 60 MPG

\$108

*All figures are based on 2005 car models. Data: Lundberg Survey BusinessWeek



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It is frightening that the bean counters' new 'target of the day' is the amount Corporate America should spend on R&D."

—Louis Janicek Ramsey, N.J.

THE SLIPPERY SLOPE OF MOVING R&D OVERSEAS

THE MOST FRIGHTENING statement in "Outsourcing innovation" (Special Report, Mar. 21) was from Quanta's Barry Lam: "It's now difficult to get good ideas from our customers." This shows what the real threat is. You can't develop new product ideas if you can't integrate intimate knowledge of the market with knowledge of emerging technologies. Companies that pretend these interlocking streams can be separated won't be around for long. The last thing they will outsource is the chief executive and the board.

—Daniel E. Whitney
 MIT Engineering Systems Div.
 Cambridge, Mass.

IT IS FRIGHTENING to think that the bean counters' new "target of the day" is the amount Corporate America should spend on R&D. In one tidy, neat statement, Allen J. Delattre of Accenture has relegated research and development to line-item status—as nothing more than the last great "controllable expense" on the ledger. Delattre's comments are those of a tactician, the same mind-set that stat-ed at the turn of the 20th century that all

new important inventions had already been invented or that Einstein was a lazy student who would amount to little.

The continuing success of America's ability to innovate needs to be articulated with a sense of strategic vision by someone who will not ask: How much do "X" save us in making our new widgets? Rather he will ask, how will our widgets revolutionize the world? Focus on the correct question, and the appropriate saving and profit will follow.

—Louis Janicek Ramsey, N.J.

THERE IS A business term for companies that leave manufacturing and design to others—they're called retailers. Once the Asian companies get their own brand name and distribution network, they won't be working for us anymore, they'll be working for themselves.

—Paul Wetzel
 Wauwatosa, Wis.

I SURELY CANNOT be the only one who has noticed the disconnect between what corporate CEOs are saying and what they are doing. On the one hand they complain that the U.S. education

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BusinessWeek

APRIL 11, 2005 (ISSN 0007-7135) ***

3928

Published weekly, except for one week in January and one in August by The McGraw-Hill Companies, Inc. **FOUNDER:** James H. McGraw (1860-1948).

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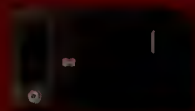


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CORRECTIONS & CLARIFICATIONS

On the introductory page of "The Business Week 50" (Cover Story, Apr. 5), the listing for a BusinessWeek Online interview incorrectly identified John Wallace and Jay Sherwood as fund managers at Standard & Poor's. In fact, they manage RS Investment Trust: MidCap Opportunities.

"Jamie Dimon's grand design" (Finance, Mar. 28) should have specified that JPMorgan's international reach was limited in consumer banking; its investment bank operates in 50 countries. Also, while JPMorgan has many dealings with hedge funds, it does not operate a prime brokerage that caters specifically to them. In addition, it ranks third in global M&A, according to Thompson Financial.

system does not focus enough on math, music, and science and does not produce enough graduates to fill high-tech engineering jobs. On the other hand, they find the talented and experienced engineers that helped build their companies so they can outsource those jobs.

—Dan Tischendorf
New Cumberland, Pa.

I THINK YOU missed a critical distinction: When the dominant design, technology, and features have been established in a category, the important work of gaining sales and share by getting those features and costs right are not the province of the high-value R&D experts or scientists. Rather, this type of work requires good intuitive and interactive work among feature engineers, usability teams, and cost-down teams.

The high-value work of inventing breakthrough science and capabilities still seems to rest with the R&D geniuses who are worth their weight in gold.

—Fred Heller
Stamford, Conn.

IT IS NAIVE to assume that Silicon Valley and the U.S. have a monopoly on creativity and innovation. The argument, cited often in this article, that intimacy with the customer is an edge in this global competition is also naive: It presumes that there are no markets other than the U.S. to which Chinese, Taiwanese, and Indian manufacturers can direct their advanced products.

Outsourcing technology development is a slippery slope. In a number of software companies I am closely familiar with, it began with sending quality-assurance work overseas, then bug-fixing (which requires

People like Bill are the reason for an investment firm like ours.

RAYMOND JAMES

Bill Townsend, 62, Semi-retired pediatrician. Transitioning practice to daughter, Beth. Starting to enjoy investment income. Recently purchased lakeside cottage where he'll teach his six granddaughters to fish.

timacy with code), and finally the entire product development (since bug-fixers eventually became coders).

—Jon Handaru
Palo Alto, Calif.

HAVE WORKED at major software companies, including such icons as Sybase Inc. and J.D. Edwards, for the past 20-plus years as a software engineer in various capacities. As far as I know, both Sybase and Oracle Corp. outsourced entire maintenance engineering to India many years ago to compete with each other. Now almost all development has moved to India. I can guarantee that next generations of database engines will start from India, not from the U.S.

No engineer starts developing high-end products from zero. Such people learn their trade from a master—as with music, carpentry, etc.—by maintaining their codes for years and in time take it to next level. We are so shortsighted on giving away our crown jewels. Maybe it is the problem with capitalism.

—Nick Shener
Alameda, Calif.

HERE'S MORE THAN ONE WAY TO BRING RADIO TO LIFE

ENJOYED "The new radio revolution" (News: Analysis & Commentary, Mar. 14). The 1996 rewrite of the Telecommunications Act was a near death blow to radio. Radio was already getting pretty boring, but letting four companies own most of the radio stations and automate boredom was criminal. Tuning across the dial, it sounds as if there are only four or five stations, cloned and repeated, playing the same tiny group of songs over and over.

The National Association of Broadcasters thinks that going digital and having CD-quality sound will save them. I think not. Digital boredom will be just as boring as analog boredom.

—Stephen Hawkins
Boone, Iowa

YOU OVERLOOKED THE one device that will grab share and revenue from current and new broadcasting technologies such as pod-casting and satellite. Although still in its infancy, the streaming of radio programming through a cell phone, known as mobile streaming, combines the best features of all other broadcasting technologies. Users can receive preprogrammed or personalized programming, purchase music they hear, and easily send recommended programming or songs to friends. Most importantly, mobile streaming provides operators with strong, recur-

ring revenue streams. There certainly is a radio revolution taking place, but the battlefield will move to the cell phone.

—Gilles Babinet
Chairman and Co-Founder
Musiwave
Paris

COMMERCIAL RADIO is becoming its own worst enemy—because it is putting profits first and customer satisfaction second. Stupid commentary from deejays, endless commercials, and the like have driven me away. It was only a matter of time until this business model came crashing down. I believe that Internet radio is in a position to become a primary medium. I like my Internet radio station so much that sometimes I have to turn it off in order to focus on my work—it's that good!

—Tom Caine
Mountain Lakes, N.J.

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It Takes a Global Village

THE END OF POVERTY Economic Possibilities for Our Time
By Jeffrey D. Sachs; Penguin Press; 396pp; \$27.95

In a foreword to Jeffrey D. Sachs's *The End of Poverty*, rock star and crusader for the underprivileged Bono aptly describes the flamboyant Columbia University economist. When Sachs delivers a speech, "he's not just animated; he's angry," writes Bono. "There is a wildness to the rhetoric but a rigor to the logic.

God might have given him a voice with an amplifier built in, but it's the argument that carries the day."

Sachs writes as passionately as he speaks. As a result, much of this book's sensible, often brilliant analysis of poverty's root causes and potential solutions is overshadowed by histrionics that by turns may leave you moved, annoyed, or even insulted. *The End of Poverty* is superb when describing the dire circumstances of the 1 billion people subsisting on less than \$1 a day. It is hard not to share Sachs's anger after reading his firsthand reporting on the miserly Western aid to African villages ravaged by AIDS, malaria, and hunger. At relatively little expense, Sachs insists, the West could provide medicines and fertilizers that could save millions of lives annually. The funds required for desperately needed roads, clinics, and water-treatment facilities are modest.

But woe to anyone who disagrees with Sachs—indeed, to anyone who has ever disagreed with him in his 25 years as adviser to developing nations and the U.N. He thinks Washington should heed his call to devote 0.7% of gross national product for antipoverty programs to be coordinated by the U.N. That would translate into a fivefold leap in U.S. development aid—or a further \$42 billion. Sachs suggests funding it largely with a new 5% tax on incomes above \$200,000. The author is actually flummoxed that some people would consider all this politically unrealistic.

The book also takes countless shots at the International Monetary Fund, Republican Administrations, and others for pushing policies at odds with Sachs's advice in Bolivia, Russia, sub-Saharan Africa, and elsewhere. Even if one agrees with his critiques, it's an odd way to build Western support for the author's two main projects: the Global Fund to Fight AIDS, Tuberculosis & Malaria, and the U.N.'s Millennium Development Goals to slash poverty by 2015. Meanwhile, Sachs never admits to having erred himself. He includes a long and feisty defense of his role in urging economic shock therapy in Russia—an approach widely condemned after the country imploded.

I wish Sachs had saved these battles for an autobiography

and kept the focus on what to do about the horrendous poverty in Africa and South Asia. Few economists have contributed more to this field in the past decade. Many of Sachs's insights stem from years of research he spearheaded while at Harvard University and, since 2002, as director of Columbia's Earth Institute. Sachs believes extreme poverty is far from an incurable curse, despite the meager results of five decades of foreign aid. To the contrary, he argues, "the end of poverty is at hand—within our generation—but only if we grasp the historic opportunity in front of us."

First, though, a rethinking of development economics is required. For too long, Sachs argues, economists have obsessed over "how to make poor countries into textbook models of good governance or efficient market economies." So the IMF and World Bank focused on ending such things as deficit spending, state ownership of industry, trade restrictions, and corruption. Such policies are important, says Sachs but far from sufficient in very poor nations.

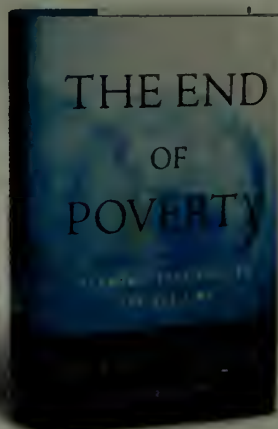
He documents the much more basic handicaps keeping Africa mired in a poverty trap. Start with the rural population's sheer isolation from clinics, water supplies, and trade routes. Farmers must scratch out an existence from poor soils. And preventable diseases take a ghastly toll on the working-age population. Without solving such life-and-death problems, African economies can't reach a level where growth can be sustained by domestic savings and investment. With per-capita incomes of \$300 or less, even relatively well-managed African nations are simply too poor to advance.

Sachs has supervised extensive research aimed at quantifying these problems. "When we get practical, and speak of investments in specific areas," he writes, "the task is suddenly a lot less daunting." He supplies many examples of successful aid programs—and shows how highly promising initiatives in AIDS, malaria, and agriculture are stalling

because they are grossly underfunded.

Those who doubt that massive injections of money are the answer won't be persuaded by Sachs's proposals. And, yes, too often he makes it sound like the war on global poverty is really all about Jeffrey Sachs. Readers should look past those irritations. At the very least, *The End of Poverty* should leave you with hope that this crisis is more curable than it seems. ■

—By Pete Engardio



A passionate plea for the West to aid desperately poor nations

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BY JAY GREENE

Beaming Your Music From Basement to Attic

The great boon of digital music has been the ability to play what you want when you want it. Thanks to innovations such as Apple Computer's iPod, which stores your entire music library, there's no need to go rummaging through CD racks to find a particular disk. Now a new wave of innovation allows you to transport that same music to any room in the house.

Devices that beam music from a PC to a stereo system aren't new. But in general, they have been difficult to set up, prone to crash, and not particularly good at searching out specific songs. Then came Sonos. The Digital Music System from this Santa Barbara (Calif.) startup blends the sound quality of a fine stereo system with the elegance of an iPod. In fact, the paperback-book-size wireless controller that manages the system looks a bit like a large iPod, complete with a touch-sensitive scroll wheel to navigate through the music library on your PC.

Sonos can connect to your existing stereo system, but the beauty is that it doesn't need to. The heart of the system is a bread-box-size device called a ZonePlayer, a digital audio receiver that connects to a PC through a router on your home network. Only one ZonePlayer needs to be wired directly to the router. With that one connected, you can beam music files to a collection of identical ZonePlayers in other rooms over a Wi-Fi network that's built right into each box. And since each Sonos player includes a 50-watt amplifier, you can use it as a stereo just by connecting speakers to the box.

IN GEEK-SPEAK, the Sonos approach is known as a peer-to-peer mesh network. Because digital songs bounce from one player to the next, creating a mesh of wireless signals blanketing the house, the tunes heard on the ZonePlayer in the bedroom sound just as clear as those on the one wired to your PC router in the study. You can link up as many as 32 players—but it won't be cheap. Each ZonePlayer costs \$499, and each remote controller is \$399. (Sonos also bundles two ZonePlayers and a remote for \$1,199.)

I tested three ZonePlayers in my house: one in the living room, one in the kids' playroom, and one in the master bedroom. More often than not, we synchronized the devices so that the same song was playing at the same time in every

IN SYNC Sonos' ZonePlayer and remote make an elegant system



room. But one night, we invited friends for dinner. The system made it easy to let the kids rock out to the Foo Fighters in the playroom while the grownups listened to Lucinda Williams in the living room.

One of the niftiest parts of the Sonos system is the wireless controller that manages the whole setup. It has a beautiful 3.5-inch color LCD screen that shows the artist, track name, and album art when music is playing. Press the "music" and the "zones" buttons, and you can pick different songs for different rooms or sync up the music in other zones. You can add Net radio stations and navigate among them with the controller.

The system, which works with Windows and Apple computers, is easy to set up. You connect each ZonePlayer by holding the box's mute and volume buttons down together. Using borrowed Bang & Olufsen BeoLab 5 speakers, which run \$16,000 a pair and pump out

Songs bounced wirelessly don't lose their clarity

2,500 watts of power, I got a whole new sense of the cash register that opens Pink Floyd's *Money*. (You may not need BeoLabs, but for great sound, don't skimp on speakers.)

Some may gripe that the system is unable to play music that is copy-protected, which includes all songs purchased legally through MSN Music store or iTunes Music Store. But for people who have built up their music libraries by copying CDs they already own, that won't be a big problem. Even Sonos' pricing scheme seems reasonable, when you consider that a high-end, multiroom sound system can easily set you back \$2,000. Sonos does so much more than conventional stereo systems—and does it with style. ■

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BY JEFFREY E. GARTEN

Andy Grove Made The Elephant Dance

Next month, Andrew S. Grove, chairman of Intel Corp., will retire after 37 years at the company. In January, 2004, Wharton School voted him the most influential business leader of the past quarter-century—above Bill Gates, Jack Welch, and Sam Walton. I would go further: He is also a superb model for future generations of CEOs.

During Grove's 1987-98 tenure as chief executive, Intel's stock price rose 31.6% a year, twice the rate of the Standard & Poor's 500-stock index, and revenues grew from \$1.9 billion to \$25.1 billion. The workforce doubled, to 64,000 people, and Intel was transformed into a global corporation, with 55% of its revenues coming from abroad. The company became central to the growth of personal computers, cell phones, genomic research, computer-aided design, and virtually everything else that characterizes this age of digitalization and the Internet.

But Grove's achievement is not defined merely by Intel's growth. Throughout his career, he demonstrated a keen ability to rebound from deep crises. In the mid-1980s, for example, he responded to Japan Inc.'s onslaught against Intel's production of memory chips by leading the company into the entirely new field of microprocessors. It was a massive change of direction, as if Caterpillar Inc. had decided quickly to retool all its bulldozer plants to start making passenger cars. Another example: In 1994, Grove managed the global recall of defective Pentium chips, a problem that almost sank the company. He did so in a manner reminiscent of the legendary skill of Johnson & Johnson CEO James E. Burke, who took the lead in J&J's Tylenol crisis.

GROVE'S GENIUS HAS BEEN to align strategy and execution as the forces of globalization were creating enormous discontinuities in the business environment. This necessitated creating a vision that was tempered by the realities of an industry in constant turmoil. He thought about his operational environment like a master chess player, always anticipating what the competition might do in response to his moves—and then what he would do in response to that.

Grove had an exceptional ability to create a work environment that married entrepreneurialism with extreme discipline. He gave his colleagues a wide berth to be innovative and to anticipate the future. But he was brutal in demanding that they measure their performance every step of the way. In an era when size is critical to global reach and when speedy adaptability is essential to survival, Intel under Grove demonstrated the way to be big and nimble. It showed that elephants really can dance.

No active business leader has written so extensively and candidly about how to ensure responsiveness to destabilizing change. In *High Output Management* (1983), for example, Grove explains how to maximize the productivity of employees, whether they make computer chips or are involved in back-office work. In *Only the Paranoid Survive* (1996), he describes how companies should deal with new competitors that emerge suddenly and with such force that they change the fundamental shape of an industry itself.

Working out of a cubicle and declining the usual executive perks, Grove was the antithesis of an imperial CEO—although he could question his colleagues so intensely as occasionally to border on intimidation. As the company's chairman since 1997, he has become a paragon of effective corporate governance. He has been a strong proponent of separating the positions of chairman and CEO and has built an active, independent board that has been deeply involved in overseeing the company's global strategies.

I asked him what he considered his greatest accomplishment. "It's that I have played a significant part in developing the work environment

and culture at the company and with the directors," he said.

In May, Grove will leave the Intel board but keep a hand in the company as an active adviser. One major project will be the application of information technology to health care and bioscience. A new book on corporate strategy will come out later this year. We should hope to continue hearing his ideas on that and many other fronts, too, including his prescriptions for preparing America for competition from China and India. At a time when many business leaders are under a cloud or hiding under the table, his courage, skills, intellect, and integrity will be sorely missed. ■■

Jeffrey E. Garten is dean of The Yale School of Management and author of *The Mind of the CEO* (jeffrey.garten@yale.edu)

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BY JAMES C. COOPER & KATHLEEN MADIGAN

Consumers May Just Keep Flexing Their Muscles

Because of overall brighter financial conditions, the spending will go on

U.S. ECONOMY U.S. consumers have shown repeatedly in recent years their ability to cope with any number of obstacles standing between them and the retail object of their affection. And in 2005 their urge to splurge will face more tests amid some new challenges, including rising inflation, record gasoline prices, and higher interest

rates. All that comes on top of some old burdens, such as heavy debt and a low savings rate.

The question: Can consumers handle it all and keep spending at a pace that will keep the economy moving forward at a healthy clip? After all, with gasoline prices already averaging \$2.40 per gallon in parts of the West Coast, many SUV owners may soon be forking over more than \$50 to fill up their 20-gallon tanks.

Even for those who don't own gas guzzlers, higher gas prices will take a bite out of household buying power this spring. Those depressing thoughts were undoubtedly a factor in the recent drop in consumer confidence. Also, as mortgage rates rise, housing demand and housing-related purchases will ease back a notch as the housing boom winds down (page 78).

Nevertheless, a leveling off in housing is not inconsistent with a healthy growth rate in consumer spending, primarily because of the excellent overall financial condition of consumers. Debt service as a share of income is down from its peak. The rush to refinance at a lower fixed rate has cut mortgage payments for many families and has provided some income protection against rising rates for those who have switched from adjustable-rate to fixed-rate loans. Delinquency rates on a variety of loans are falling. And the overall balance sheet of the household sector is the strongest ever.

Most important, the turn for the better in the job market over the past year has supplied the household sector with a growth surge in income from wages and salaries. That's a crucial support under spending that had been missing during the jobless part of the recovery.

After growing 3.8% and 3.7%, respectively, during 2003 and 2004, consumer spending still has the power to grow at a slower but quite respectable 3% clip this year. That's a pace that will keep the economy humming, especially since spending by businesses on new equipment, buildings, and inventories shows every sign of taking a larger role in powering overall demand.

IT'S A SIGN OF CONSUMERS' continued resilience that March consumer confidence held up so well (chart). The Conference Board's index fell to 102.4, from 104.4 in February. But despite last month's soaring gas prices and

its weak stock market, the reading remained well above the 98.2 average in the second half of last year. Households rated present economic conditions only a shade lower than they did in February, which was a sharp improvement from several months ago. Their expectations for the future fell as well, but to a level that historically is associated with spending growth at a rate of about 3%.

CONSUMERS LOSE SOME FAITH, BUT NOT MUCH



Given the relentless rise in gasoline prices, confidence will undoubtedly take another hit in April. The national average for unleaded regular hit \$2.15 on Mar. 28, up 20% in only three months, and it will go higher. Based on the historical relationship between the prices of crude oil and gasoline, oil

in the range of \$53 to \$54 a barrel has typically been associated with gas prices averaging around \$2.21 to \$2.24. However, the summer driving season is still a ways off, and the seasonal pattern of gas prices shows them peaking usually in May.

A 20% rise in gas prices from the first quarter could knock as much as two percentage points off the second quarter's annual rate of growth in consumer spending, as households divert more of their income to gas and less to discretionary purchases. Still, having been faced with \$2 gas last spring and then again last fall, consumers have had time to adjust their budgets, and they may now be inured to high pump prices.

THE INCREASED ABILITY of households to manage the various pressures of recent years boils down to their improved financial condition. In recent years, rising net worth has trumped the traditional arguments that heavy debts and a low savings rate will spell trouble for consumers. That's because households are discovering new vehicles for saving, and they are better able to handle a higher volume of debt. For example, since the recession

ended three years ago, household liabilities have soared by \$2.7 trillion. That compares with a rise in aftertax income of only \$1.4 trillion.

However, over the same period household assets, including everything from home values to stocks and bonds to pension funds, have grown by \$10 trillion, and assets other than home values have accounted for 53% of that rise. In the 2½ years after the stock market bust in 2000, households lost \$4.9 trillion in net worth. But since that drop bottomed out in the third quarter of 2002, households have seen all of those losses restored and then some. Overall wealth now stands \$5 trillion higher than it did at the 2000 peak.

IN THE END, THOUGH, it all comes down to household cash flow and the month-to-month ability to handle higher debt. So far, consumers have managed well. The Federal Reserve's financial obligations ratio, a measure of payments for mortgages and other loans and leases as a percentage of aftertax income, dipped to 15.96% in the fourth quarter, down from 16.03% in the third quarter and from 16.21% two years ago.

But that total masks diverging trends between servicing mortgages and all other obligations. For mortgage debt, the ratio has risen from 9.56% of income when the recovery began three years ago to 10.12% in the fourth quarter. The ratio of income required for all other debt has dropped from 6.62% to 5.83%, a nine-year low. As many households have reduced the monthly drain from revolving debt, bank loans, and car

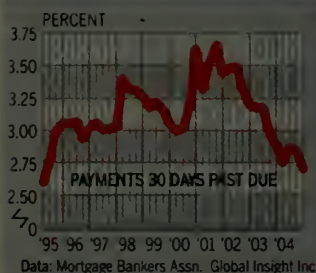
leases, they have been able to make more room for higher mortgage payments, a shift that also makes sense from a tax standpoint.

Moreover, the delinquency rates for various types of consumer loans have been falling. Late payments on auto loans, auto leases, and personal loans have declined

sharply over the past three years.

Delinquencies on revolving credit have all dropped to a low level, and even late payments on bank cards, which have the highest ratio in this group, have edged down over the past year. Finally, the percentage of mortgages that are 30 days past due is at its lowest level in 10 years,

MORTGAGE ARREARS HIT A 10-YEAR LOW



according to the Mortgage Bankers Assn. (chart)

Perhaps the most compelling plus in the consumer outlook is the new aggressiveness that Corporate America is showing in its plans to expand operations—a key factor in the recent pickup in hiring. Those jobs have translated into 6% growth in the wages and salaries of working households over the past year, the fastest pace in more than four years. With those kinds of income gains, consumers will be in excellent shape to face the financial challenges that 2005 will bring. ■

SOUTH KOREA

A Slow Recovery is Better Than None

DESPITE DISAPPOINTING February industrial production, the worst may be over for South Korea's economy. Optimism is rising on improving consumer demand. But a full-fledged recovery may not emerge until the second half of the year.

After a two-year slump because of the bursting of Korea's credit-card bubble in 2002, consumers are back in a spending mood. In the fourth quarter of 2004, private consumption rose 0.6%, up from 0.2% in the third quarter. The Bank of Korea's Composite Consumer Survey Index surged to 108 in the first quarter of 2005, from 87 in the prior period. It was the best reading since the final quarter of 2002. The report

showed that Koreans feel much better about their financial condition today and for the coming months.

What's more, consumers have the wherewithal to keep shopping. February payrolls rose by 40,000, a sixth straight monthly gain. The household savings rate, which tumbled to 1.4% in 2002, climbed back to 4.8% last year. It's an indication that personal balance sheets are noticeably improved.

Nevertheless, the February industrial output data were a reminder that the country's recovery will be slow. Output fell 7.3% year on year, although the figures were distorted by the Lunar New Year holiday. For the first two months of 2005,

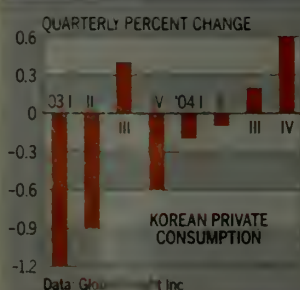
output averaged a 3.2% year-on-year increase. That was below forecasts for a 4% to 5% rise and less than the 4.6% gain in December.

The problem is that export growth is decelerating and consumer spending has yet to boost factory output. The Ministry of Finance & Economy said exports will rebound in March, rising about 13% from a year ago, after a 6.7% gain in February.

Even so, private consumption is now the most important factor for the Korean outlook, since last year's 31% surge in exports will not be repeated in 2005. With signs that the Korean won will not continue to gain value rapidly against the U.S. dollar, the biggest obstacle to accelerating economic growth may be oil. Korea imports all of its crude oil, and higher prices hit both consumption and companies' profit margins. ■

—By James Mehrling in New York
with Moon Ihwan in Seoul

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INSURANCE

AIG: WHAT WENT WRONG

A look at how the icon of insurance got itself in such a mess—and where all the probes are headed

BY DIANE BRADY AND MARCIA VICKERS

INVESTORS IN EMBATTLED AMERICAN International Group Inc. may have breathed a sigh of relief at the Mar. 28 announcement that Chairman Maurice R. “Hank” Greenberg would step aside two weeks after being pressured to give up the chief executive’s role. But the complex \$99 billion insurance and financial empire he leaves behind remains mired in turmoil.

What began as an investigation into two reinsurance transactions has mushroomed into a growing scandal that has tarnished the reputation of one of America’s premier corporations. On Mar. 30, AIG acknowledged that it had improperly accounted for the reinsurance transaction to bolster reserves, and detailed numerous other examples of problematic accounting. It also announced the delay of

its annual 10-K filing, and said the moves may have inflated its net worth by up to \$1.7 billion. While AIG says it does not yet know if the review will force a restatement of prior results, its stock dropped 2.1% on the news; all together, AIG shares have dropped 22%, to \$57 apiece, since the company was served with subpoenas by state and federal regulators six weeks ago. The announcement also caused Standard & Poor’s to downgrade AIG’s debt rating from AAA to AA+. Here’s a look at where the AIG mess stands and where the probes are headed:

What is it that has regulators up in arms?

Investigators believe that AIG may have goosed its financial performance with dubious transactions and improper accounting. Last fall, the insurer paid

\$126 million in fines to the Securities & Exchange Commission and Justice Dept. for deals it structured for outside clients that allegedly violated insurance accounting rules, although AIG admitted no wrongdoing. The company also came under the glare of New York Attorney General Eliot Spitzer for its role in bid-rigging with broker Marsh & McLennan Cos., which led to the ouster of Hank’s son Jeffrey as CEO there. AIG admitted no wrongdoing, but two of its executives plead guilty and left the company.

This time, investigators initially focused on two transactions involving Berkshire Hathaway’s General Re Corp. unit. The deals essentially amounted to a \$500 million loan that was dressed up on the books as premium revenue. That allowed AIG to boost its sagging reserves

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OUT The board finally demanded Greenberg's resignation

at a time when investors thought they were too low. The problem: AIG never assumed any of the risk associated with insurance underwriting. On Mar. 30, the company acknowledged that "the transaction documentation was improper" and should never have been classified as insurance premiums.

Since then, AIG's problems have escalated. In its Mar. 30 release, the company itself identified several problem areas. They include transactions with supposedly independent companies that were in fact controlled by AIG; bond transactions that may have allowed it to claim gains without actually selling the bonds; misclassified losses; and questionable estimates on deferred acquisition costs. Investigators and state regulators are looking into some 60 transactions involving these and other possible accounting shenanigans. "Greenberg strived for a steadily rising stock price," says a source in Spitzer's office. "He used mechanisms now being revealed as deceptive and improper."

What is the company doing at this point?

It has installed longtime AIG exec Martin J. Sullivan, 50, as the new CEO, and named independent director Frank G. Zarb as chairman. In addition, it has launched its own internal investigation, which has so far revealed several arrangements and deals that were not properly accounted for. The company says that its review is not yet complete. Moreover, AIG has pledged to change how it accounts for deferred compensation that's now paid to senior executives through Starr International Co. (SICO)—one of several controversial private entities that also are under investigation.

What are these private entities and why are they under scrutiny?

AIG has a highly unusual arrangement with three private entities, governed

Long Shadow

Hank Greenberg's presence could still loom large at AIG. He and other top AIG execs control three private entities holding 15.7% of the company's shares. Greenberg, the largest individual stockholder, personally holds another 1.7% stake.

STARR
INTERNATIONAL

11.9%

STARR
FOUNDATION

2.0%

C.V. STARR
& CO.

1.8%

GREENBERG'S
PERSONAL
STAKE

1.7%

Data: Company reports



SETBACKS
AIG may no longer command a premium stock price

AIG. It's owned and operated by AIG executive many of whom perform functions similar to what they do at AIG—and controls 1.8% of AIG shares. Critics worry that the opaque nature of its transactions, for example, could allow C.V. Starr to become a convenient tool for managing earnings at AIG, which has been a model of earnings consistency in a notoriously volatile industry. The arrangement also creates endless possibilities for conflicts of interest. Says North Carolina State Treasurer Richard Moore, who oversees his stake in AIG worth more than \$300 million: "I don't think you can have a publicly traded company that allows board members to own a private entity that does business with the publicly traded company. [It's] impossible to know what shareholders are being taken advantage of."

Finally, there's the Starr Foundation, a charitable entity which Greenberg also chairs and which has a 2% share in AIG. It has come under fire for doling out money for political causes and for giving \$36 million to the American Museum of Natural History shortly after museum President Ellen V. Futter joined AIG's board.

and controlled by Greenberg and other AIG executives. Each serves a different purpose and raises unique concerns. SICO is a holding company that owns about 12% of AIG stock—making it the company's largest shareholder—and pays out some of that stock to an elite group of AIG managers as deferred compensation. Greenberg and other AIG directors sit on the board, have large personal stakes, and decide who gets paid what. Regulators believe SICO hides executive pay and takes away powers that should rightly lie with the compensation committee of the board.

C.V. Starr & Co., on the other hand, is a group of agencies that develops business and issues specialized policies for

What pressure does Sullivan now face?

Insiders say the new chief, who began his AIG career at the age of 16, is aggressively leading the charge for changes necessary to create a more transparent organization. But the longtime AIG manager—formerly a vice-chairman and co-chief operating officer—is also under scrutiny by regulators. A close confidante of Greenberg, who essentially hand-picked Sullivan as his replacement, he also serves as a director in C.V. Starr and SICO. Sullivan has not been accused of any wrongdoing, but regulators are looking for signs that he knew of or oversaw the dubious transactions. Any hint of that and he, too, could be forced out. An AIG spokesman says Sullivan has no comment on his future or the company.

7's direction while AIG cooperates with investigators.

Greenberg out of the picture?

The 79-year-old insurance legend is due to appear before Spitzer for a deposition on Apr. 12 and may face continued scrutiny for his actions, sources say. But Greenberg still retains significant control of AIG through his 1.7% personal shareholding and stakes in the private entities that together own another 15.7%. Although the full extent of his influence is unknown, Greenberg controls 8.3% of SICO's voting stock, is President and CEO of C.V. Starr, where he owns 6.4% of the common stock, and is chairman of the Starr Foundation. The structure of SICO, in particular, has also given Greenberg enormous control because anyone who left the company—or was fired—prior to retirement often forfeited lucrative payments. “It was like joining some elite brotherhood where, if you joined the line, you were set for life,” says one insider. Investigators and directors may be hard-pressed to force Greenberg out of a private company, and he could continue to exert influence from the background.

Where was the board through this mess?

For years, AIG had a board that was notoriously clubby and close to Greenberg. Says Patrick McGurn of Institutional Shareholder Services: “Was there a reform Iank ever put in place that he liked?” But, thanks to shareholder pressure and new



LIFER Sullivan was 16 when he started at AIG

Greenberg's hand-picked heir, Sullivan, is leading the charge for more openness. But the AIG veteran is also under scrutiny

governance regulations, the board has become more independent in recent years. More important, perhaps, the investigations have made directors nervous about their own liability—and determined to take proactive action to dis-

tance themselves from any scandal, insiders say. They even demanded Greenberg's resignation—an unthinkable act just months ago.

How do regulators or other critics propose to fix these conflicts of interest?

One answer is to disband the entities, ban business dealings with the public company, or force AIG executives to end any direct roles in those companies. While a source familiar with the federal probe says regulators haven't yet demanded any specific action, he notes that “none of this is stuff I've seen in other walks of life.”

Is AIG doomed?

Sources close to the investigation are quick to point out that this is no “Enron situation, [although] there were a lot of shenanigans going on. “The insurer sells

real products and produces real earnings. The main allegation is that managers went to extreme lengths to smooth those earnings and boost the stock price. Strip out those machinations, and AIG may turn out to be a typical insurer, with big earnings swings up and down, rather than the superior underwriter it appeared to be.

But AIG remains a powerhouse in the industry. It has a diverse mix of industry-leading insurance and financial-services businesses. Moreover, it's a global force with a particularly strong foothold in fast-growing Asian markets, especially China.

At the very least, the company's shares may no longer command the kind of premium that they did during the glory days. Despite the crisis, AIG's stock has been trading at an average multiple of 16.6, vs. 15.1 for the S&P 500 Insurance Industry index. Investors, already irate over losing more than \$40 billion since the scandal broke, may have to come to terms with the fact that AIG is just a normal insurer—subject to the same lousy years and volatility as others. That means more air may still come out of AIG's shares.

But that's without factoring in the substantial hurdles that AIG faces. Transforming a culture as secretive and ingrained as the one that Greenberg built over four decades would be a monumental task for any CEO—and perhaps an impossible one for a leader who forged his entire career there, as Sullivan did. Moreover, the extent of the company's liability is unknown. There may be huge fines; there could even be more serious charges. Investors can only guess how much that will batter AIG from here. ■

—With Mike McNamee in Washington

Many Ways To Gild Earnings

In a Mar. 30 statement, AIG conceded it had improperly accounted for a controversial reinsurance deal. It detailed several previously undisclosed arrangements that may have violated accounting rules:

FINITE REINSURANCE The focus of the original investigation. AIG acknowledged that \$500 million from Berkshire Hathaway's General Re unit should have been booked as a deposit, not as premium revenue. AIG shouldered no risk in the deal, so treating it as reinsurance overstated its reserves.

COZY DEALS Three companies that provided reinsurance to AIG were in fact directly or indirectly controlled by AIG or its executives. If AIG must consolidate those units onto its own books, more than \$1 billion in income claimed since 1991 will be wiped out.

COVERED CALLS AIG's units sold call options on bonds they held, then entered into swaps that ensured AIG kept the bonds and their capital gains. The result: \$300 million in net investment income was booked early.

DELAYED EXPENSES AIG found it had been too aggressive in deferring expenses for commissions and other costs of selling insurance. Writing off those deferred costs could reduce earnings by as much as \$370 million.

MISCLASSIFIED LOSSES Admitting that it used “an improper structure” with a reinsurer, AIG must now restate \$200 million in capital losses as underwriting losses. Underwriting losses hit operating profits—the earnings measure that insurance investors focus on.

Data: AIG



TARGET AIG plaintiffs may also sue the auditors

ACCOUNTING

Tough Questions For AIG's Auditors

Where were the auditors? Now that American International Group Inc. has admitted to a clutch of accounting improprieties and is mulling whether to restate its past results, an all-too-familiar question is emerging: Why didn't the auditor catch what was going on?

Were misdoings hidden from AIG's longtime auditing firm, PricewaterhouseCoopers, or did the firm turn a blind eye to problems it should have seen? Indeed, some of the searing heat that has so far felled AIG Chief Executive Maurice R. "Hank" Greenberg and several other execs could soon scorch the \$17.5 billion accounting giant. "I'm sure they will be under suspicion," says J. Edward Ketzi, associate professor of accounting at Pennsylvania State University.

Because of its role as a dominant force in auditing and accounting for insurance companies, PricewaterhouseCoopers' work for the outfit is bound to get an especially close going-over from regulators and shareholders alike. Certainly, the outfits were close. PwC or its predecessor companies, such as Coopers & Lybrand, had

done work for AIG going back more than 20 years. How deep were the ties? Recently ousted Chief Financial Officer Howard I. Smith, whom AIG fired for refusing to cooperate with investigators in the latest probes, had worked at Coopers & Lybrand for 19 years and was the head partner in its New York insurance practice before joining AIG in 1984.

More important, PwC was AIG's auditor through its long years of questionable dealings. AIG on Mar. 30 said that deals with a Barbados-based insurance company, for instance, may have been incorrectly accounted for over the past 14 years, because an AIG-affiliated company may have been secretly covering that insurer's losses. If AIG has to unwind its dealings with the Barbados company, it may be forced to take a big earnings hit. More recently, PwC appears to have dropped the ball on the now-notorious reinsurance deals between AIG and Berkshire Hathaway Inc.'s General Re Corp.

In those deals, General Re transferred \$500 million in anticipated claims and premiums to AIG. At issue for PwC: Did the auditor do its job by verifying that AIG was assuming risk on claims beyond the \$500 million, thus allowing AIG to account for the deal as insurance? That's Accounting 101 in any reinsurance transaction. But the company itself now admits the business should have been accounted for as a deposit rather than as insurance. "The auditor obviously should really stop and think about this because the transaction really doesn't pass the smell test," says Penn State's Ketzi.

In its statement, AIG has admitted that some of the paperwork associated with the deals was improper—but it's not clear whether the deals were illegal or how much PwC was told about them. AIG says much of the information only recently came to light. And PwC could have been duped or denied information. But given PwC's long-standing relationship with AIG, the thoroughness of its auditing over many years will surely come under question. "These seem like things you'd expect an auditor to look at," says New York attorney Gerald H. Silk, a plaintiffs' lawyer whose firm has brought cases against Arthur Andersen and other big auditing firms. "There are sufficient red flags." PwC declined comment, citing client confidentiality requirements, although the firm is said to be cooperating with investigators.

How vulnerable could PwC be? Already, institutional shareholders, who sued AIG last fall when its stock began a 21% plunge amid the investigations, are considering roping the auditing firm into a class action. "As the case develops we'll be bringing in other responsible parties," says Thomas A. Dubbs, a New York lawyer for three big Ohio pension

funds that have lost tens of millions of dollars on their AIG holdings. Dubbs, working on behalf of the Ohio Attorney General in the class action, adds that PwC may be among the shareholder targets. And regulators say PwC could also face regulatory action.

PwC's level of culpability could take years to sort out. Just what the firm knew, or should have known, is bound to be a much-contested

issue. Already, though, it is looking at a hefty blemish on its role as a leader in insurance accounting. The growing tumult born of AIG's questionable accounting is just beginning.

—By Joseph Weber in Chicago, with Mike McNamee in Washington and Marcia Vickers and Diane Brady in New York

Regulators are probing if PwC let the financial shenanigans slip through

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MEMO TO: MARK HURD

FROM: **PETER BURROWS AND BEN ELGIN**

CONGRATULATIONS, AND WELCOME to the Big Leagues. It must feel pretty good to have beaten out all those better-known names—although you have undoubtedly got wind of what the Silicon Valley digerati think about your being tapped to become the next CEO of Hewlett-Packard Co. They say that restoring the \$80 billion outfit to glory may be an impossible job for anyone, let alone someone who has never held a position outside the much-tinier NCR Corp., a \$6 billion computer company located in sleepy Dayton.

Well, you already know not to expect overnight miracles. Sure, your cost-cutting and detailed business planning helped turn NCR's \$220 million loss into a \$285 million profit during the two years you manned the helm. But that followed years in which NCR was extricating itself from money-losing PC and computer-services businesses. Even with all the recent success, NCR's stock had only finally returned to the price it boasted when the company was purchased by AT&T way back in 1991. And the 15% swoon NCR has suffered since you took the HP job put it well below that mark again.

But fear not. If you take it slow and build on HP's still-impressive assets, there's plenty of room to make meaningful progress. Here's how:

EXECUTE—THEN STRATEGIZE

THE BIG DEBATE over HP, of course, is whether poor execution is to blame for its woes or whether the company has the wrong strategy. While some analysts believe it's time to spin off the PC or printer divisions, the board continues to argue that, with the right executive, the various businesses are better off under one roof. That's the right call for now. As you said at your first HP press conference in answer to a question about spinning off the

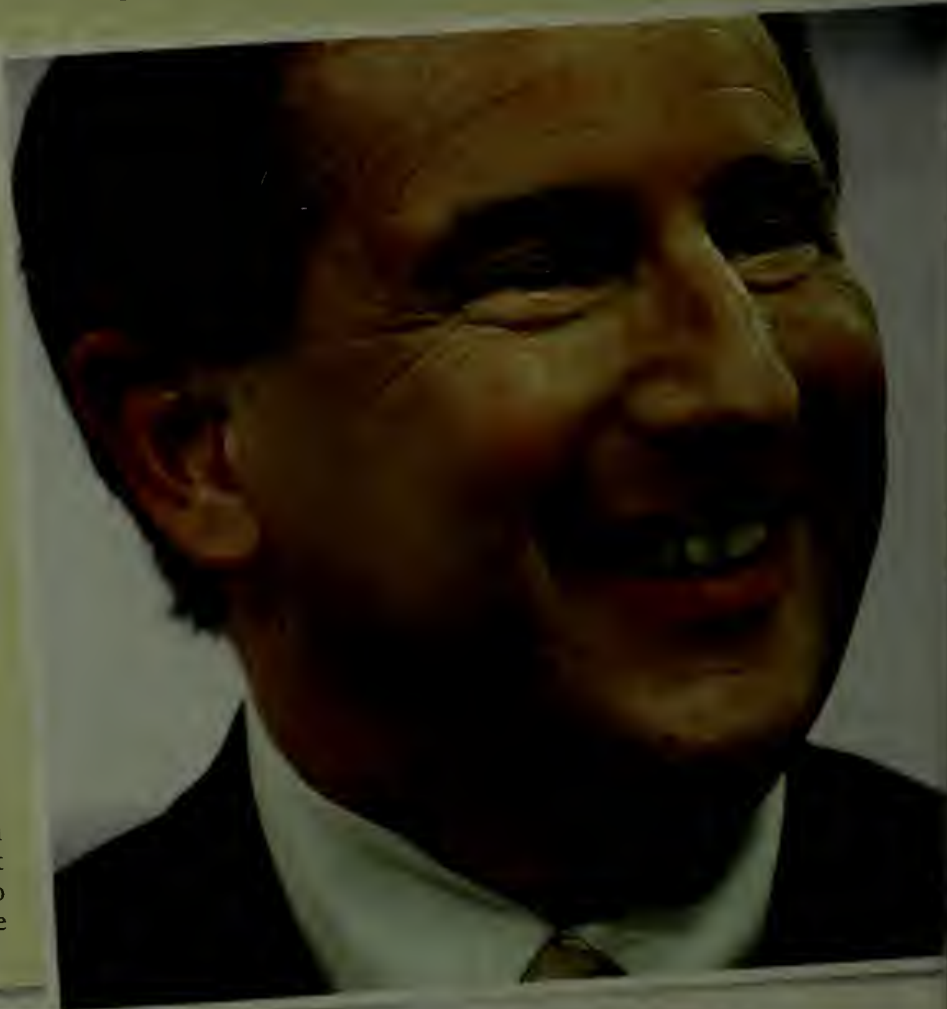
printer business: "I would prefer to analyze the situation and see if there are other ways that we can...get this company to its optimal operational performance."

Wall Street is likely to give you some time to get HP firing on all cylinders. But you'll still have to move quickly to prove the doubters wrong. One place to start: Take the board's suggestion to assign some strong executives to run parts of the business—especially in the consumer world, where you have no experience. In a year or so you should have a good idea of whether stronger execution is enough to truly lift HP performance. If not, you may have to consider hiving off a unit. Or you might decide to focus less on your ailing server and storage businesses and more on helping customers make other companies' products work together. By focusing quickly and clearly on improving execution, you will be able to make a far better decision down the road on whether to stick to the strategy.

LIVE UP TO THE LOGO

LET'S FACE IT, HP is fast forgetting how to innovate. The company hasn't cooked up an industry-shaking invention since its inkjet printers hit the market two decades ago, squaring that reality with the famous "Invent" logo.

HP has strayed from its technology roots as it struggles to pace with superefficient Dell Inc. Investment in research and development, which totaled more than 10% of HP sales in the early 1990s, has waned to 4% of sales today. Its R&D sales ratio is lower than virtually every technology company from IBM and EMC to Apple and Lexmark. The sole exception



Dell and its belt-tightening R&D outlay of 1% of sales.

But HP will never out-Dell Dell. It's a loser's game—as you found out at NCR, which stopped making PCs years ago. Sure, HP needs to be smarter about how it spends R&D money. But that doesn't mean you can underinvest. Instead, rerun that play you scored with at NCR's Teradata unit. Rather than building computers from scratch, you cranked up the unit's R&D spending to make its sophisticated data-mining software run like the wind on garden-variety hardware. That lowered operating costs and exposed a rich new source of lofty software margins. HP needs to do the same. Hunt down me-too projects and focus on those that will set HP apart in everything from digital entertainment to corporate software.

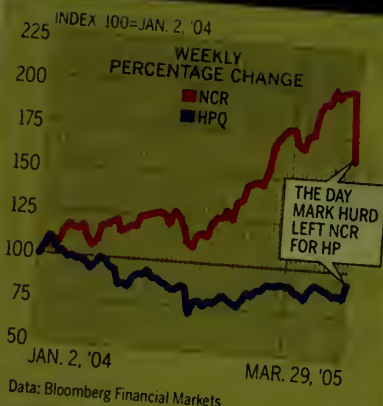
One more thing: In recent years, HP has used R&D more to maintain market position and less to aggressively pursue new growth areas—including in the cash-cow printer business. You'd do well to reverse that emphasis, fast. For example, with more focus on its Indigo unit, HP could revolutionize aspects of commercial printing. The company has been talking for years about building a cheaper version of Indigo's high-speed digital printer, which could make inroads against old-school offset printers. The rewards could be huge. If Indigo ever goes mainstream, HP would be able to sell buckets of the pricey liquid toner used in the machine—helping to compensate for falling margins in the inkjet printer-cartridge business.

BOLSTER THE BENCH

SOMEHOW, A COMPANY that was once a mecca for talented executives can't lure new people. Just one of HP's current dozen top execs, besides you, was hired from outside HP and Compaq in recent years. The board is similarly underpowered and includes not one chief executive. Meanwhile, talented execs have fled in droves.

Your first challenge will be to prevent more from doing the same, starting with gifted printer chief

TALE OF TWO CEOs



Vyomesh Joshi. He could leave after being passed up for the top job. But he's a veteran HPer who loves the company, so the right incentives—and the freedom to continue running his own show—could convince him to stay. Bringing in some new blood will also be crucial. And to show you're not some invader from the East, try to rehire respected HP veterans such as Webb McKinney, the former PC chief.

Finally, don't go it alone, as your predecessor, Carleton S. Fiorina, tried to do. When she arrived from Lucent Technologies Inc., she brought only her executive coach. Invite some of your most trusted colleagues to join you—especially tough types who can take some heat for the cost-cutting you'll have to do.

FORGET THE UBER-SALESFORCE

ONE OF FIORINA'S top priorities was to create a unified salesforce that would sell all of HP's products. The idea was to transform the company from a fragmented gizmo-maker into a soup-to-nuts supplier. The plan looked great on paper, and it worked like a charm for IBM. But while Big Blue was able to do that by providing plenty of software and consulting advice along with its various computers, HP is primarily a product company. Also, while a chief information officer may write the check for IBM to build a sweeping back-end system, there's no one single person buying everything HP has to offer—from printer cartridges to supercomputers.

Yes, NCR's success has been based partly on your ability to find synergies between disparate businesses—ATMs, retail-checkout gear, and computer systems. But ease off the synergy theme for now at HP. Scores of promising products and technologies have been stillborn in recent years because they got lost inside HP's huge salesforce. And the push away from sales specialists harpooned HP's efforts in such key businesses as storage, where niche expertise is crucial. You're better off with specialized sales staff who can get in the face of such focused rivals as Dell and EMC Corp.

HARNESS THE "HP WAY"

WHEN FIORINA WAS first hired, HP's board wanted her to declare war on what it deemed an outdated corporate culture. While the so-called HP Way pushed authority down as far as possible into the organization, the board felt the company needed more top-down decisiveness to keep up with nimbler boom-era rivals. There was some truth in that—but only some. The power of the HP Way was that techies knew management would give them the tools and freedom to turn innovations into big new businesses—so long as they hit their numbers. HP needed an overseer to make this happen, not a corporate DNA transplant. Fiorina's reforms ended up creating new bureaucracy while fraying the all-important faith of the troops.

So the best advice we've got is rethink the rethinking of the HP Way. It's not perfect, but properly harnessed, it may be the most unique advantage you have. "We want to believe," says one Boise (Idaho) staffer. "We love this place." Of course, that doesn't mean going back in time. But just as you helped hone NCR's strategy by concentrating on the best opportunities, HPers need a boss with the smarts to spot the best ideas—and who can obliterate obstacles that prevent the troops from turning those ideas into profitable growth. Your task is monumental, but you've certainly got the skills to pull it off. Good luck—and ignore those Valley naysayers. ■

TEAM BUILDER

Top priority: restoring HP's ability to execute

TELECOM

WHY QWEST CAN'T TAKE NO FOR AN ANSWER

MCI's board has chosen Verizon for the second time, but the fight isn't over yet

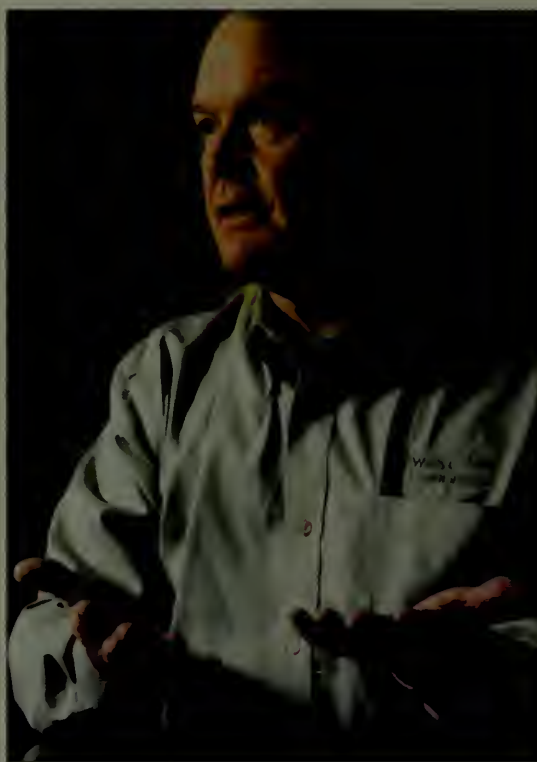
RICHARD C. NOTEBAERT decided to put his foot down. The feisty chairman of Qwest Communications International Inc. had been trying for more than a month to get MCI Inc.'s board to accept his offer for their company. So on Mar. 28, he sent MCI a letter saying that Qwest would drop its bid if he didn't hear back from the company in a week. He got his answer the very next day: MCI accepted a revised \$7.6 billion proposal from Verizon Communications Inc.—\$800 million below Notebaert's last offer.

It may seem like the ultimate corporate rebuff, and it has left the 57-year-old telecom veteran considering his dwindling options. But it's a rejection Notebaert can't afford to accept, given how much Qwest needs MCI to improve its competitive and financial position.

NOW WHAT? Notebaert needs MCI's assets

So Notebaert will likely raise his bid once again. And this time, all indications are that Notebaert will bypass the board and take his case directly to MCI shareholders. He has hired New York City-based proxy solicitation firm the Altman Group to tally up where MCI shareholders stand. And some are already giving Notebaert the thumbs-up. "If the MCI board is not cooperating with Qwest, then they should go to the owners," says Bruce R. Berkowitz, president of investment managers Fairholme Capital Management LLC and MCI's third-largest shareholder with a 3.5% stake.

Good thing for Notebaert that he has some powerful investors on his side. Clearly, the MCI board wishes he would just go away. In an official statement, MCI's board said it again accepted the rival Verizon offer because of Verizon's larger



Qwest in a Bind

Rejected by MCI twice, the ailing telecom faces tough choices:

FOLD 'EM Qwest could walk away and look for other deals; bankers believe it could roll up rural phone companies or court a stable suitor such as BellSouth.

RAISE AGAIN Its future dim without MCI, Qwest has little to lose in upping its bid again; some MCI shareholders also want Qwest to guarantee a price in the event its stock falls.

CHANGE THE GAME After raising its offer, Qwest could launch a high-stakes battle to win backing from MCI shareholders. Its options: propose its own board slate, launch a tender offer, or urge shareholders to vote against the Verizon bid.

size, wireless capabilities, the strength of its capital structure, and its ongoing ability to invest in MCI's network. Stuck with \$17 billion in debt and a share price that would barely buy a latte at Starbucks, Qwest seems like a riskier bet for an MCI board still stung by the scandals and bankruptcy of the former WorldCom Inc.

LOBBYING GAME

WINNING OVER INVESTORS will clearly require a substantially higher offer, perhaps to as high as \$29 per share, from Notebaert's current offer of \$26. That would add another \$1 billion to the price tag. The added cash will be key to Qwest's long shot bid to keep its chance alive: Some MCI shareholders are saying publicly that Verizon's offer at about 10% less than the Qwest bid, is close enough to win their support.

To gain advantage in his fight, Notebaert is also likely to step up lobbying Congress and officials at the Federal Communications Commission. For weeks, Notebaert has been arguing that a combination of Verizon and MCI, coupled with the already announced merger of AT&T Corp. and SBC Communications Inc., would give those two Goliaths a stranglehold on business customers. That tactic, though, is unlikely to get him very far. Washington insiders say that at best he'll win divestitures of some MCI equipment. "It's likely Qwest will haunt the Verizon-MCI deal through the regulatory and antitrust review process, but they have little chance of blocking it," says Scott C. Cleland, regulatory analyst at the Precursor Group research firm in Washington.

That's why Notebaert's best shot for success is to launch an all-out shareholder battle in combination with a higher bid. So what would that fight look like? He could propose new board members at MCI's annual meeting in May, a long shot at this late date. Or Qwest could launch a tender offer for MCI shares, but that would trigger anti-takeover initiatives that would still give MCI's board final say. So Notebaert's best chance may simply be to lobby MCI shareholders to vote against the Verizon merger. It's hardly a sure thing, but with his options dwindling, it may be all Notebaert has left. ■

—By Christopher Palmeri in Los Angeles and Brian Grow in Atlanta with Catherine Yang in Washington



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BIOTECH

DRAWING A BEAD ON SIDE EFFECTS

Drugmakers are figuring out ways to make some old remedies safer

IN HER 14-YEAR FIGHT AGAINST breast cancer, Janet Powell has become all too familiar with the foul side effects of chemotherapy. Treatments left her wracked with nausea, hot flashes, and uncontrollable tingling in her hands and feet. Powell's only relief came in 2002, when she enrolled in a clinical trial of Abraxane, a drug derived from a popular chemo treatment but reengineered to cause fewer side effects. "All of a sudden I started feeling really good," says Powell, a 57-year-old secretary in Greenville, Tex. "I almost forgot I had cancer."

Abraxane, approved by the Food & Drug Administration in January, is part of a growing class of drugs designed to improve on flawed, older ones. American Pharmaceutical Partners Inc. (APP) created it by reformulating Taxol, a 13-year-old chemo drug, to remove the ingredient that makes patients feel sick.

The battle against harmful side effects is emerging as a promising new frontier for the drug industry. Some companies, like APP, aim to remove noxious chemicals. Others hope to salvage bad drugs by improving the way the body digests them. Yet others use what they have learned about side effects to overhaul their development process. Together, these strategies could resurrect hundreds of pharmaceutical flameouts—drugs that were pulled from the market, or never made it out of the lab because of adverse reactions.

There couldn't be a better time for companies to zero in on drug side effects. Ever since Merck & Co. withdrew Vioxx last year, the pharmaceutical industry has

been pelted with one safety concern after another. The latest: On Mar. 25, Abbott Laboratories said it would stop selling a 30-year-old drug called Cylert that can cause fatal liver problems.

An Abbott spokeswoman says the company will discontinue Cylert, used to treat attention deficit hyperactivity disorder, because of declining sales. But the withdrawal came just days after a consumer group petitioned the FDA to pull it. Now, Johnson & Johnson is facing questions about one of its fast-growing cardiac treatments (page 44). All told, the FDA has issued 23 safety alerts this year—three times as many as it put out by this time last year.

The number of such warnings would fall dramatically if side effects could be engineered out. And that challenge has inspired some ingenious approaches. For example, ARYx Therapeutics Inc. in Santa Clara, Calif., is trying to correct flaws in the way some drugs are broken down in the liver. Its first target is Propulsid, an acid-reflux treatment that J&J pulled in 2000.

It turns out that when patients ingested Propulsid along with certain other drugs, the combination depleted the supply of an important but rare enzyme in the liver that breaks down the drug. So too much Propulsid passed into the blood, where it touched off other problems: It blocked the flow of potassium to the heart, causing irregular, potentially fatal heartbeats. By redesigning one section



POWELL "All of a sudden I started feeling really good. I almost forgot I had cancer"

of the Propulsid molecule, ARYx created drug that fights acid reflux, bypasses the problematic enzyme, and causes no health risk. The drug is still in mid-stage trial but if it works, the market potential could be huge: Propulsid hit nearly \$1 billion in annual sales before it was yanked.

COMPARING GENES

AS PHARMACEUTICAL companies decode the secrets of side effects, they're using that knowledge to design safer drugs from the get-go. At Merck, scientists are collecting data about patterns of genes that become active or inactive when drugs cause serious effects. The database helps them to flag new molecules that cause similar genetic patterns, allowing them to throw out potentially harmful compounds. And a handful of pharmaceutical companies has licensed a screening system developed by the Salk Institute for Biological Studies in San Diego. The test pinpoints drugs likely to trip a potentially lethal chain of events, in which the body flushes out other drugs the patient is taking before they can work.

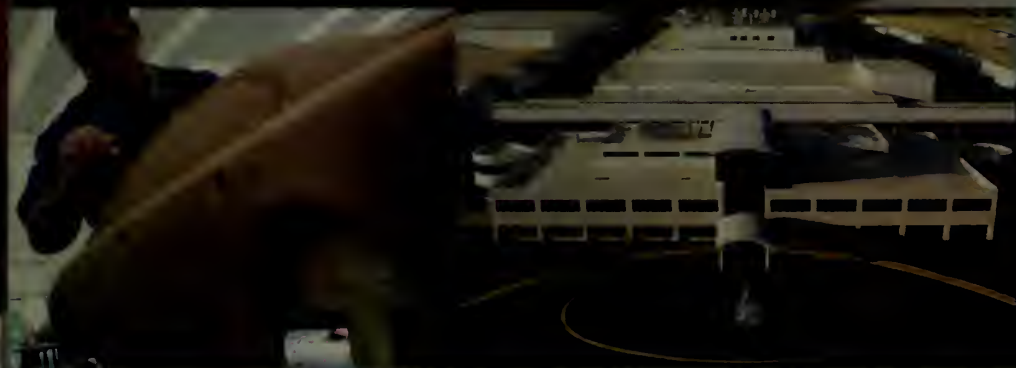
Despite the promise of such tools, getting reformulated drugs to market will require more than technical prowess. Some enterprising drug designers may be blocked by broad patents that other pharmaceutical companies hold. Then there's the regulatory minefield. Even though the drugs are based on existing treat-

THE STAT

23

Drug-safety alerts issued by the FDA so far this year, up from seven by this time last year.

Data: Food & Drug Administration



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ments, no one can predict whether the reformulations will work until they undergo years of human testing.

With so many reformulated drugs still unproven, all eyes are on the recent O.K. for APP's Abraxane. The compound is designed to fix a core problem with Taxol: Before it can be injected into patients, it must be dissolved in a solvent so noxious it can cause life-threatening allergic reactions. Dr. Patrick Soon-Shiong, founder and chairman of the Schaumburg (Ill.) biotech, figured out how to replace the solvent with nanoparticles of human protein, each one-hundredth the size of a red

blood cell, that envelop the drug and deliver it straight to tumors. The protein, albumin, normally carries nutrients to tumors that help them to grow. "We're tricking the tumor into believing it's eating a nutrient, when in fact it's getting the drug," Soon-Shiong explains.

Several cancer centers are now testing Abraxane to see if the gentler formulation will save lives by allowing doctors to deliver higher doses of chemo over shorter periods of time. And APP hopes to apply its technology to other cancer treatments on the market, as well as some that never made it into human testing because no

one could figure out how to dissolve the Abraxane could bring in sales of up to \$155 million this year and grow 40% annually for the next several years, analysts estimate. As more and more patients face their lives threatened by treatments that were supposed to save them, companies that blaze new pathways to safety will be richly rewarded. ■

—By Arlene Weintraub in New York
with Michael Arndt in Chicago

BusinessWeek online For more on the fight against drug side effects, go to www.businessweek.com/extras.

PHARMACEUTICALS

A Prescription For Trouble at J&J?

Back in mid-March, when a paper in the medical journal *Circulation* raised questions about possible kidney problems associated with Johnson & Johnson's heart-failure drug Natrecor, the company moved swiftly to defend the potential blockbuster. Execs argued that much of the journal data was based on doses well above those approved and used by doctors. At approved doses, they pointed out, no evidence of increased risk of kidney failure or need for dialysis has emerged. Wall Street was reassured, and J&J's stock actually gained ground in the days after the paper's publication.

But despite J&J's public relations push, the Natrecor controversy is only beginning. Several top cardiologists, including two on the Food & Drug Administration panel that recommended approval of the drug in 2001, are now voicing an even greater concern: A key trial of the drug showed it might be linked to a higher death rate. If those fears prove true, it could limit the potential of a drug that some on Wall Street expected to surpass \$1 billion in sales by 2007.

Scios, the J&J unit that developed Natrecor, continues to insist it is safe. And so far, the FDA has not pushed for a new trial to assess the mortality risks, nor has the company completed a study specifically on the issue. But given the recent problems with Vioxx and other drugs, experts say J&J needs to take Natrecor's potential problems more seriously. "We've had data for some time that mortality goes in the wrong

direction with this drug," says Dr. Milton Packer, a cardiologist who chaired the FDA panel that recommended the drug's approval. He says the panel made its decision because the drug appeared to ease the labored breathing of patients hospitalized with congestive heart failure. But he says the panel also said the drug warranted further study.

In the key trial done to gain approval, the mortality rate for patients six months after they got the drug was higher than for those who received the older drug nitroglycerin. While the trial wasn't large enough to prove conclusively that there was a higher death rate, it was a sign of a possible problem.

Scios insists complications muddled results from that trial. Dr. Darlene Horton, the company's senior vice-president for clinical research, says the people who got Natrecor were higher risk patients than those getting nitroglycerin due to kidney and other problems. So when you adjust for the differences in health between the two groups, the increased death rate

disappears. And while she acknowledges that the issue of a higher mortality rate has not been definitively answered, she says Scios has a large clinical trial program under way that will ultimately answer the question.

Until now, the FDA hasn't been too concerned either. Dr. Robert J. Temple, associate director of medical policy, says the agency didn't require another trial to answer the mortality question for many reasons, one being that the class of drugs including Natrecor, which work by relaxing blood vessels, haven't been linked to big safety problems in the past.

But more and more people are taking the drug—and some for longer periods than originally intended. While Natrecor was studied for short-term treatment of acute heart-failure symptoms, cardiologists say some doctors are giving it to patients over several weeks in the hope that it cuts down on rehospitalizations and deaths. And while Scios is conducting studies looking at longer-term use, for now there's limited data on the potential risks or benefits.

If successful, those trials could open up a big new market. No doubt J&J, which paid \$2.4 billion for Scios in 2003 in part due to the promise of Natrecor, is putting big bucks behind exploring all the potential benefits of the drug. But the pressure

is building to provide answers to nagging questions about risks.

—By Amy Barrett in Philadelphia
with John Carey in Washington



THE STAT

\$686 MILLION

Projected Natrecor sales in 2005—twice the level of 2004

Data: i group Smith-Barne

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EDITED BY MONICA GAGNIER

HEADLINER

STEVE REINEMUND



RESTOCKING PEPSI

It's a tribute to PepsiCo CEO **Steve Reinemund** that investors barely batted an eye at the Mar. 30 news that beverage chief Gary Rodkin is leaving voluntarily in June to pursue other opportunities. Rodkin's exit is a chance to groom two fast-rising stars, Dawn Hudson, 47, and John Compton, 43, who will split his duties. Dividing the job gives each executive a promotion. It doesn't necessarily mean the unit, which has been posting good results, is too big to manage.

Hudson, an ad exec before joining Pepsi in 1996, made her mark with the "Joy of Cola" campaign. She is now charged with expanding bottled soda sales. Compton ran Frito-Lay for two years and in 2001 helped integrate Quaker Oats and its Gatorade brand in North America with Pepsi following their merger. He takes over the Tropicana, Quaker, and Gatorade brands.

At 56, Reinemund isn't leaving PepsiCo anytime soon. But it's never too early to start grooming the talent for when he does retire.

-Nanette Byrnes

FRIENDLIER SKIES

At long last, things may be looking up for airlines. **American Airlines**, the nation's biggest carrier, said on Mar. 29 that first-quarter unit revenue will rise as much as 3.9% from a year ago, well above analysts' forecasts. Although fuel prices remain sky-high, the carrier is benefiting from **Delta Air Lines'** withdrawal from American's home hub of Dallas-Fort Worth. Bankrupt **United Airlines** also has been cutting domestic capacity, ceding some long-route traffic to American and others. American shares rose 11%, to \$11.03, on Mar. 30, after **Merrill Lynch** upgraded its rating on the stock to buy from neutral. Investors shouldn't celebrate too much, though: Merrill still expects American to lose \$200 million in the first quarter and \$800 million for all of 2005.

IT'S OFF TO WORK HE GOES



Six months before he is set to become chief executive, **Walt Disney** President Robert Iger is already remaking the company he will inherit from Michael Eisner. On Mar. 29, Disney ended its nearly year-long stalemate with Miramax Film Co-Chairmen Bob and Harvey Weinstein, producers

of such hits as *Chicago* and *The Aviator* (with Warner Bros.). Iger agreed to fund some films from the Weinstein brothers' new studio, which will co-produce sequels to hits like *Spy Kids* and *Scary Movie*. Iger also overhauled Disney's powerful strategic planning unit, which Disney execs have blamed for squelching new initiatives. Next on Iger's to-do list: opening talks with partner **Pixar Animation Studios**, which is threatening to leave Disney next year.

SILVER LAKE'S GOLDEN DEAL

It won't be easy to knock the crown off leveraged buyout king **Kohlberg Kravis Roberts** for the biggest private equity deal in history. The New York shop paid almost \$30 billion for **RJR Nabisco** in 1989. But now that sluggish stock market returns are driving investors into private equity, the megadeal is back in style. On Mar. 28, seven firms led by **Silver Lake Partners** acquired Wayne (Pa.)-based **SunGard Data Systems**, a data-processing and backup services outfit, for \$36 a share in cash, or \$11.3 billion. That deal trumped the nearly \$7 billion that **KKR**, **Bain Capital**, and **Vornado Realty Trust** paid earlier in the month for retailer **Toys 'R' Us**.

A LESS GRAND RAPIDS

Hard-hit Central Michigan was dealt another body blow on Mar. 28, when the world's largest office-furniture maker, **Steelcase**, announced plans to close three factories and lay off 600 workers in its hometown of Grand Rapids. The furniture maker says it will save \$35 million to \$45 million a year by moving

work to other plants in Michigan, Georgia, and Mexico. After three bad years, office furniture sale are picking up, but high steel prices are squeezing profits. On Mar. 30, Steelcase reported net income of \$12.7 million for its fiscal year ended Feb. 2, vs. a \$23.8 million loss for the previous year.

ET CETERA...

» The **IRS** says taxpayers are cheating the **U.S. Treasury** by up to \$353 billion a year.

» The **EU** approved the acquisition of **Metro-Goldwyn Mayer** by a group led by **Sony**.

» Chipmaker **Micron Technology** took a quarterly profit after a year-earlier loss.

CLOSING BELL

Shares of **HCA** climbed more than 7%, to \$52.41, in the two trading days ended on Mar. 30. Two days earlier, the Nashville hospital chain forecast a first-quarter earnings gain of up to 35%. HCA cited a decline in the share of patients who don't pay their bills.





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NORTHWEST AIRLINES

BY RICHARD S. DUNHAM

Bush Isn't Playing So Well In Peoria

BY TRADITIONAL POLITICAL standards, George W. Bush has been on a roll. He has made clear progress in his drive to bring democracy to the Middle East. He has won major legislative victories on long-stalled priorities including class-action curbs and oil drilling in the Arctic National Wildlife Refuge. And

Wall Street prognosticators—citing robust job gains, solid gross domestic product growth, and unquenchable consumer spending—are convinced the country's economic fundamentals remain strong.

If only the President could convince the American people that he's doing so well. Five months after winning a second term, Bush's job-approval ratings have declined to 43% in a Mar. 21-22 CBS News study, down from 51% in November and just two points above the lowest of his Presidency.

Public Angst

WHILE MANY PUNDITS are quick to argue that the recent drop reflected the public's negative reaction to Bush's intervention in the Terri Schiavo case, veteran pollsters feel that the major reasons for the slippage lie elsewhere. The prime causes: a backlash against the President's Social Security initiative and public angst about the economy, fueled primarily by

soaring gasoline prices. Despite generally upbeat business news, there is "a significant increase in pessimism about the economy," says Gallup Poll Editor-in-Chief Frank Newport.

That's borne out by Gallup's polling. In January just 3% of Americans said fuel costs headed their list of economic concerns. Now, with gasoline topping the \$2 mark, pump prices have tied unemployment as the leading pocket-book issue. And only 30% of those polled by American Research Group in March think that the economy will get better in the next year, while 38% expect it to deteriorate.

Bush has suffered from sagging

ratings in the past, and he has always bounced back with good news—such as the capture of Saddam Hussein or his reelection victory. Bush's recent slippage is "very modest, given the [negative] press attention these past few weeks," says Republican pollster William D. McInturff. And intense support from GOP conservatives will keep him from falling too far. Says Democratic pollster Mark S. Manly: "It's hard to imagine him going much below 43% without a recession or a terrible calamity striking the nation."

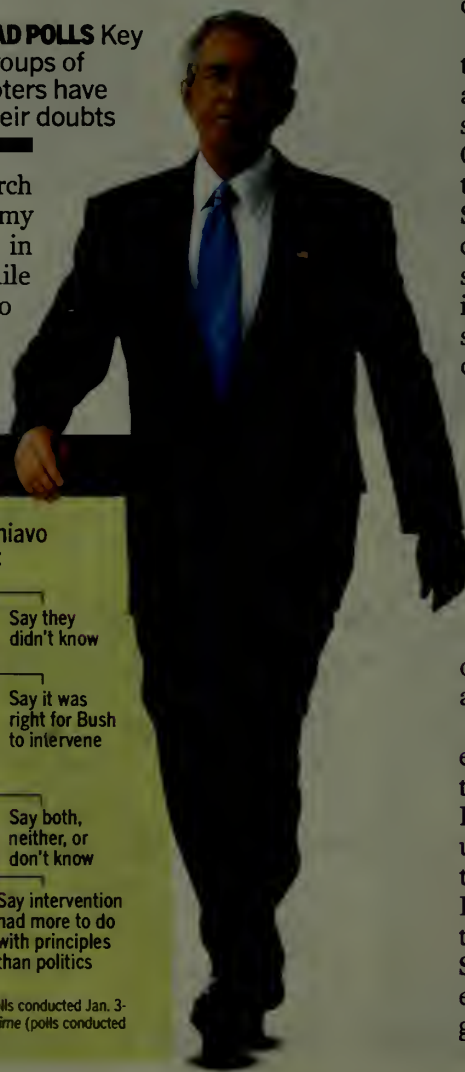
Red-State Campaign

BUT WHAT OUGHT to worry Bush is that many of the voters giving him big marks on the economy and Social Security were key supporters in the 2000 campaign. Among the recent defectors are residents of rural areas, Southern blue-collar whites, and older men. "For many of these people, moral issues were No. 1 in 2004," says Susan MacManus, a political scientist at the University of South Florida. "But they feel they're being squeezed by the economy, health-care costs, and gas prices, and they worry about the risks of Social Security reform."

Bush advisers know that the President needs a polling reversal to persuade some nervous Capitol Hill Republicans to fall into line on Social Security private accounts. That's why he's spending so much time in red states, trying to shore up support for Social Security reform with recent trips to Iowa, New Mexico, and Florida. To date, however, "the President hasn't moved the ball much down the field in terms of convincing the public of the need for [his kind of] change," McInturff acknowledges.

With the midterm elections 18 months off, there's plenty of time for Bush to recover. But until gas prices begin to moderate—and the President either turns things around on Social Security or cuts his losses—Republicans have good reason to sweat.

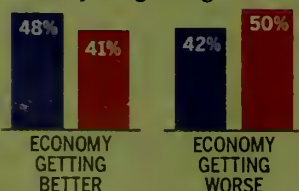
BAD POLLS Key groups of voters have their doubts



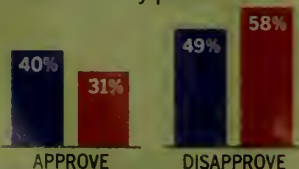
WHY BUSH'S NUMBERS ARE SLIPPING

■ JANUARY ■ MARCH

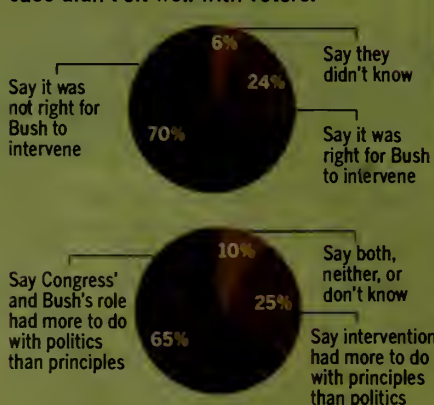
Concerns about the economy are growing:



Doubts rise on his Social Security push:



And Bush's role in the Terri Schiavo case didn't sit well with voters:



Data: On the economy, the Gallup Organization (polls conducted Jan. 3-5 and Mar. 7-10); on Social Security and Schiavo, Time (polls conducted Jan. 12-13 and Mar. 22-24)



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A photograph of a middle-aged man with a balding head, laughing heartily. He is wearing a dark sweater over a collared shirt. His right hand is raised with fingers spread. The background is a clear blue sky with some dark silhouettes of trees or hills in the distance.

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EDITED BY ROSE BRADY

Britain: The Tories Are Coming on Strong

ON MAR. 21, **BRITISH CONSERVATIVE** leader Michael Howard visited a site east of London where, to the chagrin of local residents, a band of nomadic Irish Travellers has settled illegally. His purpose: To launch a Tory effort to crack down on such unauthorized settlements. "People claim it's racist to raise this issue,"

Howard declared later at a press conference. "It has nothing to do with race. It's about standing up for the right values."

Any day now, Prime Minister Tony Blair is expected to call a general election for early May. The race is revving up, and Howard's visit to the Travellers (a group that prefers this term to Gypsies) reflects a key shift in British campaign tactics. Under Blair, the centrist winner of two landslides, the stark distinctions between Left and Right that dominated British politics for decades have faded. Now, with little separating the major parties on economic or foreign policy, debate is shifting to issues that stir emotion and win TV coverage.

Howard is taking a lesson from President George W. Bush's emphasis on social issues. The Tory leader watched Bush ride concerns about religion, abortion rights, and gay marriage to an election victory last fall. Howard is hoping to do the same by playing on Britons' fear of being swamped by asylum-seekers and other immigrants, and on their worries about crime. Howard is also appealing to longstanding concerns that Britain will lose its identity to an intrusive European Union.

For a taste of Howard's tactics, visit the Conservative Party Web site (conservatives.com): A display flips between pictures of a demonically smiling Blair and a pious-looking Howard. Blair, the captions say, favors "unlimited, uncontrolled immigration," while Howard, the son of Jewish immigrants, is for "limited, controlled immigration." The Tory boss wants to put an annual quota on immigrants, process asy-

lum-seekers abroad, and subject some newcomers to HIV tests. Such tactics are credited to Howard's new adviser, Lynton Crosby, an Australian guru who played a key role in the bruising and successful campaigns of Australian Prime Minister John Howard.

Drawbridge Politics

POLLS SHOW THAT the Tory leader's appeal to Britons' anxiety and nationalism is working. A survey by YouGov Ltd. taken on Mar. 21-24, after the Traveller-camp visit, showed that Labour's lead over the Conservatives slipped from six points in February to just one point, 35% to 34%. "The Tories are tapping into some deep-seated sentiments. A

lot of people would like to pull up the drawbridge and lock the door," says Peter Kellner, YouGov's chairman.

Will drawbridge politics put Howard over the top? Britain's political districting still heavily favors Labour, so most pollsters think Blair will win—although with a reduced parliamentary majority from the present 161. A fight over Howard's move to

dump a party official, who was secretly recorded saying a Tory government would cut spending more than Howard has publicly said, could also damage the Conservatives.

Still, Howard's forays into values-based politics could have lasting influence. That worries analysts like Kellner, who thinks emotional issues may edge out the substantive debate that still prevails in British politics. Howard has already pushed Blair into promising a points system to gauge the economic value of potential immigrants. The question is how far Howard and Blair will let the politics of fear go. ■

—By Stanley Reed in London



HOWARD Has he found the way to beat Blair?

GLOBAL WRAPUP

A MESSY TRANSITION IN HONG KONG

AFTER THE resignation of Hong Kong's unpopular Chief Executive, **Tung Chee Hwa**, in March, the Chinese government is facing opposition as it tries to push through its favored replacement, **Donald Tsang**. Beijing wants Tsang to serve out the last two years of Tung's term, but Hong Kong's Basic Law, the territory's mini-constitution, says nothing about a replacement serving a shortened term. Meanwhile, Beijing's choice of Tsang, who was financial secretary under former British Governor Chris Patten, isn't going over well with pro-Beijing politicians in Hong Kong who see him as the embodiment of the pre-1997 colonial order. And pro-democracy firebrand legislator **Emily Lau** may run against Tsang. She has no chance of winning, since the election is decided by a committee that isn't likely to challenge China. Still, the whole process could get messy for Beijing.

VENEZUELA'S CHAVEZ WINS MORE SUPPORT

AT A SUMMIT in Venezuela on Mar. 29, President **Hugo Chávez** won new backing from Spain and Brazil. Spanish Prime Minister **José Luis Rodríguez Zapatero**, inked a deal to sell \$1.7 billion in military patrol ships and transport planes to Caracas. And Brazilian President **Luiz Inácio Lula da Silva**, who recently agreed to sell Chávez 50 light combat aircraft, voiced his strong support for the former Army paratrooper. The moves may irritate the U.S., which is worried that Chávez' arms buildup could destabilize the region. The Bush Administration has criticized Russia's recent sale of 100,000 AK-47 rifles to Venezuela.



At most companies, large and small, business travel is such a significant part of corporate operations that T&E can cost as much as IT or payroll. In fact, travel is a corporation's second or third largest controllable expense. To better manage travel costs, companies are implementing a number of best practices, collectively known as travel management.

Monitor and analyze travel expenditures at a company-wide level. Understanding travel patterns and volume is the first step in creating a sound travel program.

Set, communicate, enforce and adjust travel policy. Policy is the linchpin of any travel program. Essentially, it's the rules that determine who may spend what amount with which vendors. The guidelines cover everything from when travelers can fly in Business Class to what hotel chain should be booked to what vehicle class to rent.

"The importance of travel policy has grown as companies have strived not

NBTA's Corporate Travel Management 2005

MANAGE TRAVEL TO CREATE VALUE

Travel management is the practice of approaching corporate travel strategically. Managed travel programs balance employee needs with corporate goals, maximize the value of every travel dollar, ensure cost tracking and control, facilitate travel policy adherence, create savings through negotiated discounts, and mitigate risk by centralizing all employee travel information.

A recent survey of business travelers shows how travel management policies create savings and control costs. Travelers in managed programs were more than 20 percent more likely than those in unmanaged programs to report their companies have at least one of 14 travel policy elements in place.

But managed travel offers more than cost containment. Travelers in managed travel programs were more likely to agree the programs are easy to use, make it easy to travel for business, are designed to lower travel costs, and keep employees' comfort and safety in mind.

Learn how your company can benefit from travel management, and how travel departments can leverage the education and resources from the National Business Travel Association — visit www.nbta.org.

only to control costs, but also to comply with Sarbanes-Oxley regulations," says Carol Devine, director, strategic sourcing for BNSF Railway Company and president & CEO of National Business Travel Association (NBTA).

No policy is effective unless it's enforced, Devine added. Best-practice companies flag exceptions at the point of sale; many travel managers also carry out regular audits, and take action against improper spending.

Put a payment platform in place. Consolidate all travel spending onto a single payment vehicle, such as a corporate card. This way, companies can capture accurate information, no matter

Departures



Arrivals



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MALAYSIA AIRLINES FLEET UNDERGOES TOTAL CABIN REDESIGN

Malaysia Airlines is nearly finished with a striking cabin redesign on the fleet's 32 Boeing 747 and 777 aircraft. According to Vladimir Velasco, marketing manager for North America, passengers will enjoy new sleeper seats in Business and First class, as well as buddy seats (First Class only), ottoman-type seats that will allow fine dining for two.

New menus have been developed by well-known chefs, and à la carte service allows passengers to choose from an array of ethnic, vegetarian and organic meals. The entire plane will have an upgraded in-flight entertainment system. In First and Business Class, extras include noise-canceling headphones, mood lighting, electronic window shutters and touch-screen monitors. Business travelers will have satellite phone, fax and air-to-ground services as well as seat-to-seat telephones. "The redesign is a major undertaking, but we have listened and responded to what our passengers want in total comfort and service," said Velasco.

Malaysia Airlines is the largest passenger carrier in Southeast Asia, flying to more than 100 destinations on six continents. Known for its exemplary in-flight service, Malaysia Airlines has won numerous international awards for best cabin staff, best airline lounge, best Business Class and overall best airline.

how travel is booked — by travel agent, through a portal, or directly with the vendor.

The information that can be mined from card information is invaluable. First, it will give an overview on totals, which then can be broken down by traveler, department, business unit, etc. Second, the information about your company's spending behavior is of vital interest to vendors, who are interested in competing for your business.

Negotiate corporate travel contracts and discounts. One of the travel manager's most strategic functions is to negotiate contracts with airlines, hotels, car rental companies, and other travel providers. The agreements should be designed

to ensure that corporate goals (safety, cost-efficiency) and traveler needs (comfort, productivity) are met.

Travel managers also audit contract compliance to ensure that agreements are met and any variance is corrected.

Suppliers may actually be the source of interesting savings opportunities. Travel companies like Oakwood Worldwide are adding services and becoming more in tune with their customers' needs. Radio Shack's senior director of employee

relations services Jeff Bland agrees. "Oakwood's Total Solution has been terrific," he said. "Not only have they provided exceptional service, but they have been diligent in keeping our costs in line with budget."

Likewise, work with airline partners to see whether special marketing programs dovetail with your company's travel patterns. Malaysia Airlines, for example, recently launched the AccessAsia Premier Pass, good from two U.S. gateways — Los Angeles and Newark — to Kuala Lumpur; from there, travelers can fly to three additional Asian cities, gratis, within 21 days. Fares are extremely affordable: base rates are \$3,777 for Business Class and \$5,777 for First Class.

Globalize. Many companies are working toward travel management policies and practices that extend throughout their business units and locations. Globalization leverages the benefits and values offered by a managed travel program, and multiplies them across the enterprise.

"To be truly global, your program cost savings and benefits should be evident internally within your company as well as to your suppliers in order to fully realize the maximum potential for your program," says Kevin Iwamoto, global air & car supplier manager for Hewlett-Packard and NBTA chairman/past president.

Create strategic meetings management programs (SMMPs).

SMMPs apply the fundamental concepts of corporate travel purchasing, which focuses on individual travelers, to group travel. "Travel managers are in an ideal position to provide value in this area," summed up NBTA's Carol Devine, "since they're already familiar with sourcing, negotiations and contracts."

At Hewlett-Packard, Lea McLeod, director, travel and meeting services is launching a new business process that puts the right meeting management tools in the hands of planners throughout the organization. "Our meetings vary from workforce development to reseller and customer events," McLeod explained, "and many of these meetings are organized by people who aren't full-time planners. We're providing a standard set of tools and processes to help them optimize procurement, planning, negotiating and payment. Then, with all this information in one place, managers can make better decisions around what meetings they're having, how much they cost, what it costs to cancel, etc."

Mandate an online booking system. By having travelers book their own travel, companies can save hundreds of thousands, even millions, on travel agency transaction fees. And travelers turn out to be frugal shoppers. "We've found that our travelers will really shop for the best fares when they're making bookings themselves," says Tim Bone, global sourcing manager for Agilent Technologies. "They know what their budgets are, and when they see their options on-screen and are directly accountable for their flight selection, they invariably choose lower fares."

Web Resources**Malaysia Airlines**

<http://www.malaysiaairlinesusa.com>

National Business Travel Association

<http://www.nbta.org>

Oakwood Worldwide

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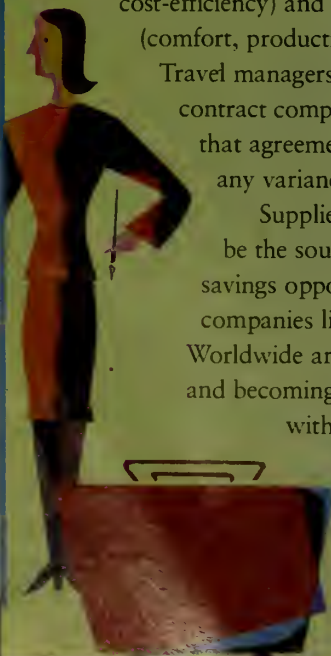
Writer: Julie Moline is a business travel specialist and a frequent contributor to various consumer, trade and in-flight publications.

Design: Sundberg & Associates Inc

Illustration: Linda Bleck

Produced by: Meigs Media Group, Inc., Millbrook, NY.
E-mail: jon@meigsmedia.com, www.meigsmedia.com

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Oakwood's approach to service touches everything from the layout (interiors focus on aesthetics, comfort and guest productivity) to location (in quiet residential neighborhoods rather than on the highway) to cost effectiveness (in some markets, an Oakwood apartment costs significantly less than a hotel room).

Corporate service innovations abound as well.

- **The Oakwood Total Solution Program** allows companies to outsource all of their housing requirements, whether they're for corporate housing or traditional hotels, to Oakwood. A single call handles booking and billing, no matter where the guest stays. "Because we've made agreements with lodging companies across the globe, we can offer this omnibus solution to our customers," said Founder and Chairman Howard Ruby. "The agreements cover a network of more than 5,000 domestic properties. Our goal," Ruby explained, "is to continue adding services and global locations to make us indispensable to our clients."
- The recently introduced client portal, **eOakwood**, provides 24/7 access to key housing data. eOakwood's eInvoicing feature provides access to consolidated statements and all invoices.
- **eConnectivity**, a closed-loop data transfer system, links Oakwood's global clients' I.S. systems directly to Oakwood Worldwide. In addition to facilitating seamless booking, the secure system allows for online bill paying, customized reporting and employee tracking.

Also to be launched in 2005 is **myOakwood**, an online resident portal and virtual concierge, providing detailed information on the apartment and the neighborhood. The site is interactive, so guests can make service requests online, book future reservations, and much more.

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Another Case Entirely

The former AOL chairman's latest gig: A daring bet on hospitality and health care. **BY CATHERINE YANG**

STEPHEN M. CASE, THE Internet Age icon who built America Online Inc. and then plunged into one of the most disastrous mergers of the century with Time Warner Inc., certainly didn't walk away from the company unscathed. But if he suffers any lingering anxieties about initiating the deal with Gerald M. Levin that eventually caused the stock to lose \$135 billion in market value, fear of failure isn't one of them. He gave up his position as chairman in May, 2003, amid much recrimination and no small amount of frustration and disappointment. Many thought that someone whose empire had so dramatically imploded would, or should, live in self-imposed exile for a while. But Case, then only 44, was wealthy enough and ambitious enough to think he could start anew.

Within days of his departure, Case began talking with his former chief of staff, Donn M. Davis, about putting together a venture that would keep him a safe distance from the world in which his failures were still all too evident. Now, nearly two years later, Case has unveiled to *BusinessWeek* the details of his new company, Revolution, which he will officially launch on Apr. 4. Revolution is a private holding company that Case is funding with \$500 million of his estimated \$825 million fortune and that will invest in health care, wellness, and resorts.

Wellness—the New Age buzzword for everything from spa treatments to organic food—and resorts because Case believes in the next two decades they will move from the province of the elite to the mainstream, as aging baby boomers seek their comforts; health care because when his older brother, Daniel

NEW DIGS Steve Case at the D.C. offices of his startup, Revolution



Case III, was diagnosed with what proved to be a fatal brain cancer, he saw for himself just how difficult it is for even the privileged to make well-informed decisions about their care. Case will spend about half of that \$500 million on companies that help patients take a more active role in their treatment. He is interested in those that provide online data about the price and quality of doctors and those that make available electronic medical records; he's considering everything from high-end personalized health coaching services to clinics housed in Target stores. As he says: "Health care is monumentally complex, confusing, inefficient, and inconvenient. Meanwhile it's the biggest industry in the country, and everybody hates it."

LIFE-ALTERING EXPERIENCES

THAT THE VERY PRIVATE Case is even seeking a high-profile comeback in business suggests that he, at least, has put behind him the very public drubbing he took at Time Warner, where he came to stand for the vilified tech industry that snookered so many. As Warren G. Bennis, distinguished professor of business administration at University of Southern California, says: "I know a lot of people who were badly hurt by that merger and will never forgive Steve Case for what he has done." The controversy over AOL continues to this day, and Case's legal troubles are not over. On Mar. 21, Time Warner settled Securities & Exchange Commission allegations of accounting violations at AOL, after having resolved Justice Dept. criminal charges last year, without admitting or denying wrongdoing; the total settlement comes to \$510 million. But the investigations are ongoing. Case, who remains a Time Warner board member, as well as other directors and executives may be on the hook for multimillion-dollar damages in a pending shareholder class action.

Now, in the most extensive set of interviews since he stepped

down, a relaxed and sanguine Case talks about what he learned from the AOL-Time Warner fiasco and from Dan's death in 2002. Revolution is very much a reflection of those two life-altering experiences. And while Case doesn't regard this new business as a way to vindicate himself, it's hard not to see this as an expensive effort to rehabilitate his reputation. What Case will acknowledge is the very real possibility that this endeavor may amount to little. "Maybe 10 years from now, we'll be a horrible failure," he says. "But I'm willing to put my money where my mouth is."

With that, Case throws his lot in with any number of impassioned serial entrepreneurs. Those who succeed, such as Craig McCaw, Steve Jobs, and Marc Andreessen, are rare. "Track record is not a good predictor, particularly when you go outside the industry you know so well," says Raffi Amit, professor of entrepreneurship at the Wharton School. Yet in some quarters, Case is still recognized for his ability to tap into the consumer zeitgeist. "He has created one incredible

This time, Case is determined to remain in control of his business

business, and I wouldn't be surprised if he goes on to create another," says Virgin Group Ltd. Chairman Richard Branson. Case consulted with Branson, as well as Berkshire Hathaway Inc.'s Warren E. Buffett and real estate mogul Philip Anschutz, before finalizing plans for

Revolution. As for Case's own assessment of his reputation, he says: "There are lots of cycles to markets—boom and bust—and also in perceptions of people. The conventional wisdom of Steve Case as genius or fool was highly cyclical. The truth was always in the middle."

At his new venture, Case wants to avoid the mistakes he made as a corporate chieftain and return to his entrepreneurial roots. "I was a better builder than manager," he says. "I actually liked the first 10 years more than the second—and the second 10 years is where the fame and fortune came. When it went from being a little company on a crusade to a big company, I was less good at it. I was less effective." And then, with unusual candor, he says: "Maybe I was inept and ham-handed. Maybe I didn't understand the complexities of the businesses, the different

cultures, and the emotional intelligence of things."

It is Case's opinion, though, that his failure at Time Warner was not all his own doing: He was a chairman without a portfolio, a strategic thinker with little influence on strategy. To forestall that kind of situation this time around he intends to buy a majority interest in any company he invests in and to put in place executives who will allow him to stay out of the daily fray. "My new companies may fail, but at least I have control of my destiny," he says.

But the idea behind Revolution, a name he chose because it was "a little bold, a little edgy," also reveals some of Case's more personal concerns. After the death of his brother,

BIO

Stephen M. Case His new company launch reflects a number of personal concerns

BORN Aug. 21, 1958, Honolulu, Hawaii

EDUCATION B.A., Political Science, Williams College, 1980

FIRST TURNING POINT As CEO and chairman of America Online, merged it with Time Warner in January, 2001, in what came to be one of the most troubled deals of its time.

SECOND TURNING POINT Resigned as chairman of AOL Time Warner in May, 2003.

CURRENT PURSUIT Launching new company, Revolution, to run resorts, spas, and health-care businesses.

LESSON FROM THE MERGER "It's not smart to put yourself



in a position where you're held responsible for something but don't have the authority to make things happen. I'd rather buy control of companies. My new companies may fail, but at least I have control of my destiny."

MONEY He has told his kids he's giving it all away.

FAVORITE SPA TREATMENT Deep-tissue and Thai massage. "I need a good stretch. I haven't had one in 40 years."

FAMILY Married to second wife, Jean; five children.



chairman and CEO of J.P. Morgan Hambrecht & Quist, at age 44, it comes as no surprise to those who know Case that the most ambitious of his goals is to give patients more control over their health care. The brothers, just 13 months apart, grew up in a close-knit family with two other siblings in Honolulu; their father was a lawyer, their mother a schoolteacher. It was Dan who, in 1982, helped his younger brother get a job at the company that became AOL. Case says the travails at Time Warner, including AOL's slowing growth rate and allegations of fraud, were merely "frustrating" in comparison to that loss. His brother's death, he says, "was harder to deal with than any criticism of the company. It helps keep things in perspective." Case puts it another way: "I believe fame and fortune are nice, but family and faith are really more at the core of what makes people happy and fulfilled."

Health care is, of course, a wildly complicated area for a newcomer to delve into. Doctors, hospitals, employers, and insurers all operate with different imperatives, and helping to fix the system, as Case says he wants to do, could well be an ambition that eludes him. Nonetheless, with health care a cause of mounting national concern, it could be a time of great opportunity. For example, the advent of health savings accounts, which allow workers to contribute about \$5,000 a year to tax-free medical accounts that they can spend as they wish, has raised hopes that consumers' new purchasing power might finally give them a greater stake in the industry. The expectation is that when patients pay their own bills they will want more control over their care and will shop more widely for the services they need.

Case has been circumspect about specific companies he's considering acquiring but does expect to complete a few deals by late spring. One prospect may be Minneapolis-based Minute Clinic. Founded in 2002, the company runs 22 clinics in Maryland and Minnesota, many housed in Target stores. For an av-

Steve Case 2.0

His new company, **Revolution**, hopes to capitalize on baby boomers' obsessions

HEALTH CARE

THE OPPORTUNITY: Companies that help consumers manage their own care should thrive if health savings accounts, to which consumers can contribute about \$5,000, grow rapidly, as expected, in the next five years.

THE CHALLENGE: Consumers may not want to take control of their own health care after all.



WELLNESS

THE OPPORTUNITY: As boomers age, the wellness industry—including nutrition, exercise, and medicine—could grow to \$1 trillion in 2020 from more than \$400 billion today.

THE CHALLENGE: Case won't be the only one trying to create a single brand encompassing everything from organic foods to yoga.

RESORTS

THE OPPORTUNITY: Destination clubs that sell time at luxury vacation homes have quickly become a \$450 million industry.

THE CHALLENGE: Case wants to broaden membership, but that might undermine his club's image.

Data: BusinessWeek Forrester Research Inc. North Castle Partners LLC Ragatz Associates

erage of \$44 per visit, patients can receive treatment from nurse practitioners for specific ailments, such as strep throat and ear infections.

STUMBLING UPON WELLNESS

THOUGH IMPROVING health care is now central to Case's ambitions, Revolution really began as a rich man's whimsey. And because of that it is in some ways an awkward collection of companies. Soon after resigning from Time Warner, Case had lunch with Donn Davis at the California Pizza Kitchen near the Case Foundation in Washington. Over barbecued chicken pizza, Case, who at the time owned three

"second homes" that he rarely used, mused with Davis about finding a better way to vacation. Through a Web search, he discovered Denver-based Exclusive Resorts LLC started in 2002 by brothers Brad and Brent Handler. The

club offered just 42 member access to two dozen luxury homes in glamorous locales around the world. Case emailed the Handlers on May 23, they met three days later in San Diego, and over the next weekend, Case and his wife stayed at ER's property in Los Cabos, Mexico. On July 9, Case bought 50% of the company and on Nov. 22, 2004, he increased his stake to 80% and installed Davis as CEO.

Exclusive Resorts is hardly revolutionary, but Case says the company does seek to break established business models in its own elite market by becoming well, slightly less elite. Since Case took over ER, membership has grown to 1,200, and Case wants it to be 10 times that size in seven years—for better or worse, an aggressive strategy reminiscent of AOL's drive to sign up its first million subscribers. Today, full members pay a one-time \$375,000 deposit and annual dues of about \$25,000 to stay 60 days a year at any of 180 homes, each worth close to \$2.5 million. Case suggested a lower-tier membership, launched on March 1, to reach more customers. These affiliate members pay an \$185,000 deposit and \$9,500

in annual dues for 15 days at the same properties. Case created the ad tagline: "We promise you 15 perfect days a year. What you do with the other 350 is up to you." Eventually, ER plans to offer less costly membership for a group of less pricey homes.

The notion of this kind of vacation club, though, is so new that no one, except maybe Case and his executives, can say with confidence that it will prove to be more than a fad. Vacation clubs "haven't withstood the test of time," says J.W. Marriott Jr., chief executive officer of Marriott International Inc., which has no plans to get into the business. And by opening up



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membership, Case may undermine the club's snob appeal or find himself with more ready travelers than the company can accommodate.

As Case became involved with Exclusive Resorts, which was building villas at the Miraval spa in Tucson, he came to believe that the "wellness" business, a \$400 billion industry that is expected to grow to \$1 trillion by 2020, would be a natural complement to his interest in health care. And, in true Steve Case style, he felt it was in sore need of some brand-name power. Those already in the business heartily disagree. "We currently own this industry," says Kevin M. Kelly, president of Canyon Ranch Management LLC, which was founded in 1979 and includes resorts and day spas around the country, condo communities that promote their kind of healthy living, beauty products, and books.

Case, in fact, was impressed enough with Canyon Ranch to make an offer for a controlling stake in the company in early 2004. When they couldn't come to terms on a deal, Case contacted Miraval, which offers programs ranging from massage to addiction recovery to the Equine Experience, where horse therapist Wyatt Webb helps guests develop mental focus by persuading a horse to offer its hoof. On Friday, Feb. 20, Case phoned Bill O'Donnell and George Ruff, Miraval's co-owners, and offered to take them to Tucson in his Gulfstream jet on Tuesday. The talks that day went nowhere, but the next morning in the limo on the way to the airport, the owners relented and sold Case 70% of their company. Case now plans to build Miraval spas in Hawaii, Mexico, and the East Coast; in a decade, he envisions local "wellness" centers in 100 communities across America, all offering Miraval programs. And on Mar. 18, Case purchased Wisdom, the only cable channel devoted to the genre, with 6.5 million subscribers.

So far Case has spent about \$125 million to start Revolution. No one doubts that he'll put up the full half a billion dollars he has promised. But can he create a new empire? Even Case says he could be embarrassed a decade from now, having wasted a lot of time and a lot of money trying to fix health care. Good thing Case has plenty of both. He'll need them. ■

—With Kerry Capell in London

BusinessWeek online For a Q&A with Steve Case and a look at his investments in his home state of Hawaii, go to www.businessweek.com/extras



WHO NEEDS SLE
Juggling credit
and the feds w
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The CFO Behind Adelphia's Rescue

Vanessa Wittman is cleaning up a financial mess and prepping for a sale

THERE'S DUE DILIGENCE, and then there's Adelphia due diligence. Nobody knows that better than Vanessa A. Wittman, who for the past two years has served as chief financial officer for scandal-ridden cable operator Adelphia Communications Corp. That role has placed the onetime investment banker at the epicenter of one of the most complex corporate reclamations ever—the aftermath of the financial morass left by founder John Rigas and son Timothy, convicted of looting billions

from the Coudersport (Pa.) company.

The next step in this saga is about to unfold: Adelphia, which filed for federal bankruptcy protection in June, 2002, with \$19 billion in debt, is expected to announce by mid-April that it will sell its systems, which pipe cable TV into 5.2 million subscribers' homes from West Palm Beach, Fla., to Los Angeles. While Adelphia is still considering its options—including a possible bid from Cablevision, in a teamup with some private equity firms—the likely buyers will be Comcast and Time Warner Cable, with a combined offer of more than \$17 billion. That

price would reflect just how coveted the systems are, mounting to about twice Adelphia's peak market cap of \$8.4 billion in 2000. The sale will have followed a tortuous, year-long auction process in which 20 bids were submitted for all or various pieces of the company. More than 39,000 pages of financial and operational data were released, and 150

meetings were held with potential bidders. "This has been a multidimensional chess game like I've never seen before," says Nancy B. Peretsman, a managing director at Allen & Co., which has been hired by Adelphia to help conduct the auction. "Vanessa has been hugely impressive," says Peretsman. "She has been able to toggle between handling the most minute details and thinking about the larger picture, all with very little sleep."

POKER FACE

FOR THE 37-YEAR-OLD Wittman, it has been the most demanding job yet in a career that has taken her from Morgan Stanley to a stint in corporate development at Microsoft to handling the bankruptcy of telecom startup 360networks. At Adelphia she has overseen the bankruptcy even as she has done her "day job," she quips, being CFO.

The creditors have also demanded a plan for Adelphia to emerge from bankruptcy as a standalone entity. Wittman didn't let the banks dictate terms for exit financing but instead held an auction. She was able to raise \$8.8 billion for Adelphia from four banks without any upfront fees. In meeting after meeting, no matter how heated the discussions, Wittman often disarmed attendees with an ability to keep her cool. "I want to go for the jugular," says one outside lawyer, "and she just keeps a poker face." Throughout all the complex maneuvers, adds Jeffrey A. Sine, Wittman's former boss at Morgan Stanley who now, as vice-chairman of UBS Investment Banking, is running the auction with Peretsman, Wittman "has maintained her equanimity and sense of humor."

With Adelphia CEO William T. Schleyer and President Ronald Cooper, both veteran cable execs, Wittman also designed an operating budget quickly so that \$1.5 billion in financing could be tapped, ensuring continued upgrades

"I can't tell you how many times we have... said: 'Oh my God'"

of Adelphia's cable lines.

All the while, Wittman was negotiating with legions of angry creditors and shareholders, as well as cooperating with federal investigators. In a Mar. 28 government filing, Adelphia reported offering \$725 million to settle accounting-fraud allegations with the Securities & Exchange Commission and the Justice

Dept. The Rigases are set to be sentenced on Apr. 18. Another son, Michael, faces a new trial in October after a jury deadlocked over several charges in his case.

When Wittman accepted the offer to become CFO in February, 2003, she knew it would be a huge challenge. But she says nothing could have prepared her for the level of mismanagement she uncovered. Receipts were dumped, literally, in shoe boxes. Monthly cable rates, which for most operators usually vary by region and type of franchise agreement, hadn't been reviewed in years. So customers in Coudersport were paying the same as those in Beverly Hills. At the start of 2003 only 70% of Adelphia's subscribers could receive high-speed data, well below availability in the rest of industry. (Today, 96% can get the service.)

Most unsettling was the discovery that Adelphia had been reporting 40% operat-

ing margins that were actually 30%. Executives had been assigning expenses to the capital budget rather than reporting them as operating expenses, thus enabling them to boost margins. In December, after a team of 100 accountants under Wittman's charge reviewed 7 million ledger entries, Adelphia released new, audited earnings by reporting billions of dollars in losses for the years 2001 through 2003. "I can't tell you how many times we have looked at each other and said: 'Oh my God,'" says Wittman, who earned a salary and bonus of about \$1.9 million in 2003, the last year executive pay was disclosed.

Even if the federal government accepts Adelphia's settlement offer and a sale goes through, months of work lie ahead to get various approvals from creditors and a federal bankruptcy judge. Adelphia is also suing the Rigases to try to take control of some cable systems the family owns privately that Adelphia manages. So it could be at least 9 to 12 months more before there's true closure.

In the meantime, Wittman's old company, Microsoft, is looking for a CFO. And Viacom Inc. may have a couple of spots now that it plans to split in two. Wittman is certain to be on those short lists. But for now, she says, she isn't thinking beyond her next 16-hour day: "There's still a lot of work to be done here." Even so, the worst of the Adelphia debacle appears to be over. ■

—By Tom Lowry in New York

BIO

Vanessa Ames Wittman

JOB Chief Financial Officer, Adelphia Communications.

BORN Apr. 16, 1967, New London, Conn.

EDUCATION BS, Business Administration, 1989, University of North Carolina at Chapel Hill, where she was a standout tennis player; MBA, 1993, University of Virginia's Darden School of Business.

CAREER Associate, Andersen Consulting, 1989 to 1991; investment banker, Morgan Stanley, 1993 to 1996; partner, investment bank Sterling Payot, 1996 to 1997; CFO, wireless outfit Metricom, 1997 to 1999; senior director, corporate development, Microsoft, 1999 to 2000;

CFO, 360networks, 2000 to 2003.

FAMILY She and husband, Drew M. Wittman, a former tennis teaching pro, have two sons, Parker, 7, and Mason, 6. Drew quit his job at Silicon Graphics to be with the kids when Vanessa went to Adelphia.

HOBBIES Tennis, skiing, and chasing Parker and Mason through Manhattan museums.

HOW A TENNIS MATCH IS LIKE CLOSING A DEAL "When done well, both are as mentally draining as they are physically draining. Success in either requires both force and feel."

IN THE TOP DRAWER OF HER DESK

A pack of mints; \$4.98 in change; two back-up calculators; two stones that say "courage" and "confidence"; two dozen ticket stubs from movies, museums, and flights.

IF SHE HAD ONE THING TO SAY TO JOHN RIGAS, WHAT IT WOULD BE "Why?"



Giving Hybrids A Real Jolt

A plug-in gas-electric vehicle may be key in saving fuel and cutting pollution

IS THERE A CAR THAT CAN CUT America's oil imports to a trickle, dramatically reduce pollution, and do it all with currently available technology? Greg Hanssen thinks so. His company has already built one such car—a converted Toyota Prius that gets 100 to 180 mpg in a typical commute. Andrew A. Frank thinks so, too. The University of California at Davis professor has constructed a handful of such vehicles. His latest: a converted 325-horsepower Ford Explorer that goes 50 miles using no gas at all, then gets 30 mpg. "It goes like a rocket," he says.

These vehicles are quickly becoming the darlings of strange bedfellows: both conservative hawks and environmentalists, who see such fuel efficiency as key to ensuring national security and fighting climate change. Reducing dependence on the turbulent Middle East "is a war issue," says former CIA Chief R. James Woolsey, who calls the cars' potential "phenomenal."

What's the secret? It's as simple as adding more batteries and a plug to hybrids such as the Prius. That way, the batteries can be charged up at any electrical outlet—letting this so-called plug-in hybrid travel 20 to 60 miles under electric

power alone. Since most Americans drive fewer than 30 miles a day, such a car could go months without visiting the filling station (table). "The only time you would have to gas up is when you go out of town," says Felix Kramer, who founded the nonprofit California Cars Initiative to promote plug-ins. Run the internal combustion engine on a blend of gasoline and biofuels like ethanol, and it would use almost no oil products at all. "That changes the world," says Frank J. Gaffney Jr., president of the Center for Security Policy.

"TRIVIAL MATTER"

PROFESSOR FRANK, 72, first began thinking about a plug-in hybrid electric vehicle (PHEV) years ago. "But now all the pieces are here," he says. Toyota Motor Corp. has solved the big engineering problems with the Prius, so "it's a trivial matter to make a plug-in," says Joseph Romm, a former Energy Dept. official. Greg Hanssen and his colleagues at EnergyCS, for example, replaced the Prius' existing 1.3-kilowatt-hour nickel metal hydride battery with an advanced 9-kWh lithium ion battery pack. They hope to offer a conversion kit to Prius owners. The weight penalty? About 170 pounds.

Car owners might not want to try this at home. Such a conversion will probably void Toyota's warranty. But big companies are building their own vehicles. In a project

sponsored by the Electric Power Research Institute (EPRI), several utilities, government agencies, and DaimlerChrysler, the carmaker is building a fleet of up to 40 PHEV delivery vans.

Four will be coming to U.S. cities for tests starting in June. Research at EPRI predicts that the plug-in vehicles, based on DaimlerChrysler's popular Sprinter van, will get a gas mileage boost of at least 50% over conventional vans.

EPRI Program Manager Robert Graham is convinced that Toyota already has prototype plug-ins running. Toyota says no. "We keep looking at the concept and at some point it might be feasible, but it isn't there yet," says David Hermance, Toyota's executive engineer for environmental engineering. For its part, DaimlerChrysler sees its van project "as a great opportunity to

JUICED UP



REFUELING AT HOME Joe plugs his car into a wall outlet in the garage. While he sleeps, the battery fills up with off-peak electricity—the equivalent of 50¢ or less per gallon of gas. Power companies benefit, too—by selling more electricity at night.

DRIVING ON ELECTRICITY

In a typical 30-mile round trip to work, Joe can get through the day using just electricity from the battery. When Joe slows or brakes, the car's generator sends energy back to the battery.

DRIVING ON GAS

After going 40 to 60 miles, the battery runs low, and the car switches to its small gasoline engine. Like an ordinary hybrid, this car will get 50 mpg and recharge the batteries for extra acceleration when needed.



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develop the vehicles we foresee in the future," says technology spokesman Nick Cappa. The company's first hybrid offerings will be conventional, but plug-ins might eventually be an option, he says.

Auto makers' reluctance to plunge in quickly frustrates evangelists like Professor Frank. "If it is such a damn good idea, why are the car companies not adopting plug-ins?" he asks. "The simple answer is that they don't want to change what they are making." But it's also not clear how much more people will pay for the cars. Hybrids are estimated to cost \$2,000 to \$5,000 more than conventional cars to make, and the larger batteries for plug-ins would add several thousands dollars more.

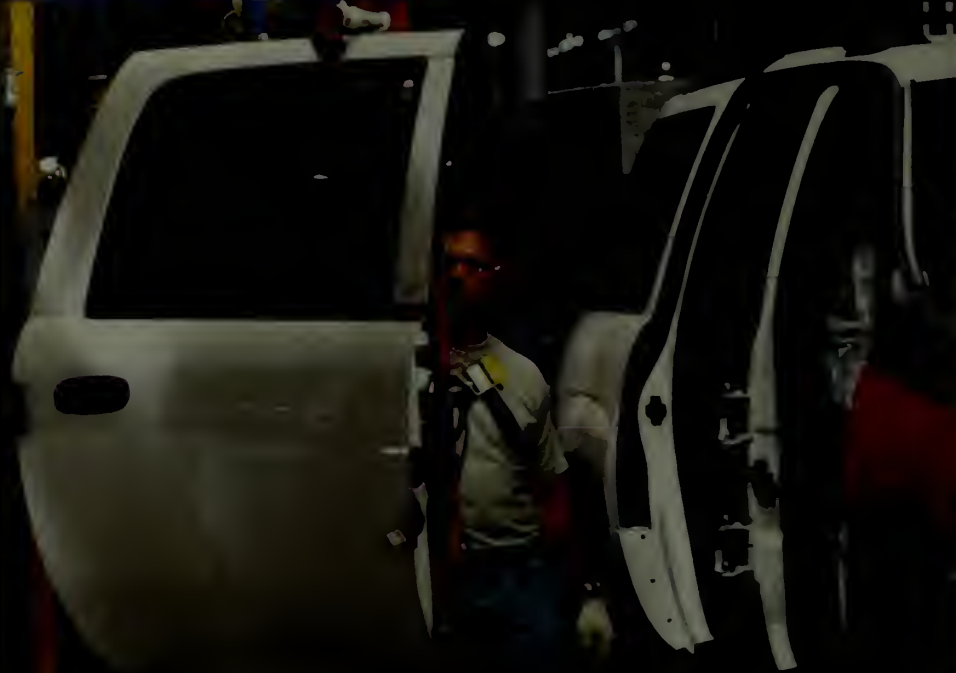
"UNCERTAINTY"

PROPOSERS PREDICT costs will drop with high-volume production. But making the investment to build hundreds of thousands of PHEVs is a giant risk, especially since there are competing approaches to higher fuel efficiency, such as advanced diesels or upgraded gasoline or hydrogen engines. Plus, no one knows if gas prices will rise enough to spur demand for high mileage cars. "All these technologies are great. But there is a tremendous amount of uncertainty," says David E. Cole, chairman of the Center for Automotive Research.

That's why some plug-in advocates are striving to create a market for auto makers. On Mar. 3, the city of Austin, Tex., passed a resolution calling for rebates for plug-in purchases and asking local businesses and governments to buy the vehicles. "We can reduce costs [of driving] to consumers, improve the air quality, and increase revenues to the city," says Roger Duncan, deputy general manager of city-owned Austin Energy.

Ordinary hybrids such as the Prius are already popular. Moving to plug-ins is the next logical step—and the idea is getting high-level endorsements. Last December, the bipartisan National Commission on Energy Policy tapped plug-ins as a key part of its energy strategy. The Set America Free coalition, a group of conservatives and enviros, is pushing for \$2 billion in incentives, pointing out that "if all cars on the road are hybrids and half are plug-in hybrid vehicles, U.S. oil imports would drop by 8 million barrels per day." Americans will be "gassing up" their cars with electrons, predicts Romm: "I would bet the mortgage on it." But not quite the whole house. ■

—By John Carey in Washington



NOBLE, OKLA. Laid-off GM line workers still get most of their pay

Will the UAW Cut GM Some Slack?

The union faces a tough call on whether to help the carmaker pare health-care costs

GENERAL MOTORS CORP. has been swinging the budget ax a lot lately. The No. 1 carmaker has demanded large price cuts from suppliers, helping drive some into bankruptcy. It has jacked up health costs for salaried workers and slashed thousands of their jobs. But its union workers and retirees have mostly gone unscathed. Its 460,000 unionized factory workers and retirees still have a top-dollar medical plan, and no one gets laid off without getting most of their pay indefinitely.

Now GM is knocking on the union's door. Management wants to slice its health-care tab. But big cuts could mean taking the contentious step of reopening GM's four-year labor deal with the United Auto Workers, which expires in 2007. Just getting UAW members to pay the same health-care contribution as white-

collar workers would save billions over the years, noted GM North America President Gary L. Cowger on Mar. 23 at the New York Auto Show. The company already has raised the issue with union leaders, and it will be discussed at a meeting between GM's top brass and union leaders scheduled for Apr. 14.

GM's request puts UAW President Ronald A. Gettelfinger in a bind. If he stiff-arms management, the company's auto business likely will slide deeper into the red, jeopardizing union jobs. But persuading union members to give big concessions will be exceedingly difficult. As far as they're concerned, much of GM's current financial woes stem at least as much from management missteps as from the company's retiree burden. What's more, workers at Ford Motor Co. and DaimlerChrysler's Chrysler Group would probably have to take a cut, too, since the union tries to keep wages and

enefits uniform among the Detroit auto makers to avoid one undermining the others. Problem is, Chrysler is riding high just now, so UAW members there will see no reason to give.

IO PUSHOVER

MOST DAMAGING of all, big health concessions could seriously undercut the UAW's ability to sell itself to nonunion workers at the fast-growing transplants, the U.S.-based factories owned by foreign auto makers. The union has recruited about 15,000 new auto-parts workers in recent years. But it has routinely struck out at the likes of Toyota, Honda, and Nissan, largely because the foreign car-makers are careful to remain competitive with UAW wages and benefits—including health care.

If the union gives too much on its first-rate medical benefits, it will have a tough time telling non-union workers that the UAW can safeguard medical coverage. And it needs to recruit them to maintain its grip on the industry. "It would be a real blow to the UAW's organizing efforts at the transplants if it agrees to cut health benefits a lot," says Sean P. McAlinden, chief economist at the Center for Automotive Research in Ann Arbor, Mich.

The result: Gettelfinger must find a way to help GM without going so far that he upsets members—or the union's recruitment strategy. One possibility is for the union to give GM relief from its pledge to pay up to 95% of wages to the thousands of workers on layoff. "We'll be responsible, but no one is going to be a pushover," says one union insider. Indeed, whatever concession he makes puts him in the uncomfortable position of having to sell his members on what amounts to a company bailout. After all, GM's expected \$2 billion loss from its auto business may be more than offset by \$2.5 billion in finance profits this year. So the problem may not seem dire to rank and filers.

It's true that GM is weighed down by the huge burden of paying pensions and health costs for 340,000-plus union retirees. But the transplants more or less match the union's costs for current workers. So union members see the legacy costs as something GM has run up by failing to protect its market share with a competitive product lineup.

This is, in fact, what's behind the latest crisis. GM has relied on large pickups and sport-utility vehicles, while foreign rivals pushed harder with more efficient crossover SUVs. GM's new cars—the Buick LaCrosse sedan, Chevrolet Cobalt compact, and Pontiac G6 midsize car—are seen as dull and haven't sold well. And while GM invested \$4.5 billion in a troubled Fiat, its rivals invested in fresh models.

The dilemma is that GM needs the help, no matter who's at fault for its woes. Medical insurance for its union retirees will bite \$5.3 billion from the company's North American pretax automotive profits this

year—\$1 billion more than last year. Right now, GM's salaried workers pay \$100 a month in co-pays for their medical premium, plus \$10 for generic drugs and \$25 for brand-name prescriptions. Union members make no co-payment for the premium and smaller drug co-pays. Just getting UAW members to agree to a \$100 a month co-pay on the premium would save \$550 million a year. Matching the white-collar payments down the line would save GM \$1.2 billion a year, McAlinden estimates.

To catch a break, GM must find a way to help Gettelfinger sell a deal to his members. "Management will have to convince union members that this will save jobs in the long run," says University of California at Berkeley labor economics professor Harley Shaiken. It will also have to persuade the union that giving up a little won't jeopardize the UAW's long-term position in the U.S. auto industry. ■

—By David Welch in Detroit

If the union gives in too much on health care, it could hurt recruiting

The UAW: Losing Ground

Union membership is eroding as mostly nonunion jobs climb at foreign-owned plants

	1993	2003
DETROIT*	427,000	304,000
FOREIGN TRANSPLANTS**	35,000	53,000

*General Motors, Ford, Chrysler, Delphi, and Visteon
Data: Center for Automotive Research
**BMW, Honda, Mercedes, Mitsubishi, Nissan, NUMMI, Subaru/Izuzu, Toyota

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and JUMP
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WINNER Wynn's new hotel creates 10,000 jobs

ny Curtis, publisher of the *Las Vegas Advisor*, a newsletter for gamblers. "He has put everything in showing he's the guy who makes the best resorts in the world."

Wynn began plotting his comeback just a month after agreeing to sell Mirage Resorts, when he plunked down \$270 million to buy the old Desert Inn. In the past, Wynn's credo was bigger-is-better, but the new property is designed to be more intimate. With 2,700 hotel rooms and 111,000 square feet of casino space, it's about a third smaller than rivals such as the Bellagio, the Venetian and the MGM Grand. And Wynn has learned from miscues at his other properties. The hotel's centerpiece will be a multi-med-

light-and-water show over the lake. But unlike attractions at other properties he has designed, the view from the street isn't blocked by an 18-story man-made mountain; to enjoy the spectacle, you have to eat at a restaurant or book a room.

THE BACCARAT BUNCH

WYNN HAS ALREADY begun an extensive marketing campaign. He has opened sales offices in 13 cities, many of them in Asia, and cut a cross-promotional relationship with Société des Bains de Mer, a publicly traded company majority owned by the principality of Monaco that runs the casinos there. Wynn also ran TV ads during the Super Bowl and the Oscars. They featured a grinning Wynn standing atop the new hotel proclaiming it "the only one I've ever signed my name to."

Wynn's timing couldn't be better. With MGM in the process of merging with Mandalay Resort Group, and with Harrah's Entertainment Inc. buying

'The Revenge Of Steve Wynn'

Kirk Kerkorian took Mirage Resorts away from him. Now he's striking back

AT THE HIRING OFFICE for the new Wynn Resorts Ltd. casino in Las Vegas, parking lot attendants carry flashlights to direct applicants like jets on a busy runway. Arte Nathan, Wynn's human resources chief, says he has 108,700 applications for 10,000 jobs. Two thousand offers have gone out to employees of rival casino operator MGM Mirage Inc., which has banned Nathan from setting foot on its properties.

The hiring boom is just the latest salvo in what's shaping up to be the biggest casino war Sin City has ever seen. On Apr. 28 industry legend Stephen A. Wynn will open the first new resort in five years on the Las Vegas Strip. At a cost of \$2.7 billion, Wynn Las Vegas will be the most expensive casino in the world, boasting features such as a three-acre man-

made lake, a Maserati/Ferrari dealership, and the Strip's only golf course. Wynn, 63, will be competing head-to-head with MGM, whose largest shareholder, Kirk Kerkorian, snatched Wynn's Mirage Resorts Inc. away from him in a hostile takeover five years ago. "It's going to be the revenge of Steve Wynn," says Antho-

Wynn's Biggest Bet



After a five-year absence, casino mogul Steve Wynn is returning with a splashy new hotel.

OPENING On Apr. 28, following a \$7,500-a-couple benefit gala.

COST \$2.7 billion, the most expensive casino/hotel in the world.

PAYOFF Cash flow is estimated at \$350 million for 2006, generating a modest return on capital of 13%.

ROOMS Average price: \$270 per night. Appointments include flat-screen TVs in bathrooms, automatic drapery controls at bedside.



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Lipper determined the smaller fund group awards by averaging the decile rank of the three-year Consistent Return scores for all of the firm's funds within the asset class, and the eligible group with the lowest average decile rank received the award for that asset class. In case of a tie, the group with the lower average percentile rank received the award. Smaller fund groups must have at least three equity, three bond, or three mixed equity portfolios that received Consistent Return scores as of December 31, 2004 to be eligible for a fund group award in the respective asset class. Smaller fund groups with at least three equity, three bond, and three mixed equity portfolios that received Consistent Return scores as of December 31, 2004 are eligible for an overall fund family award. Although Lipper makes reasonable efforts to ensure the accuracy and reliability of the data contained herein, the accuracy is not guaranteed by Lipper. Users acknowledge that they have not relied upon any warranty, condition, guarantee, or representation made by Lipper. Any use of the data for analyzing, managing, or trading financial instruments is at the user's own risk. This is not an offer to buy or sell securities.

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The Corporation Strategies

Caesars Entertainment Inc., he'll have his pick of top managers at the outfits being acquired. By targeting high-end players with fancy new suites and baccarat tables, Wynn is likely to siphon off as much as \$75 million in cash flow from MGM, says J.P. Morgan Securities Inc. casino analyst Harry C. Curtis. Harrah's, which traditionally targets middle-market gamblers, may reduce the focus its new flagship Caesars Palace places on high-end customers, creating more business for Wynn.

In public, rival casino operators say that new properties are good for Vegas because they create more reasons for people to come to town. Behind the scenes, however, they compete fiercely for the kind of gamblers who feel comfortable betting \$10,000 or more per hand. MGM may already have launched its counteroffensive. They're throwing tons of events, shopping sprees, baccarat tournaments, fishing trips," says Steve Conigliaro, an independent businessman who hosts high rollers at various casinos. "Steve Wynn is going to take some business away. He knows what people like."

Wynn's reputation is that of a man obsessed with details. Daniel R. Lee, who

served as chief financial officer at Wynn's Mirage Resorts and who now runs casino operator Pinnacle Entertainment Inc., remembers Wynn criticizing what Lee thought had been a well-executed annual report. "He told me there was a split infinitive on page 23," recalls Lee, who immediately corrected the error at a cost of \$9,000. After Lee told his boss, Wynn replied:

"When you're close to perfect, why wouldn't you try for perfect?" Wynn declined to be interviewed.

As Wynn found out, though, such standards can be costly. He lost control of Mirage largely because investors grew unhappy with his prodigious spending on projects such as the \$685 million Beau Rivage Hotel & Casino in Biloxi, Miss., and on a \$200 million corporate art collection. Shades of those days are already apparent at Wynn Las Vegas, where design changes such as a second theater added \$300 million to the original budget. But this time around, Wynn and Japanese businessman Kazuo Okada control almost half of the stock, making

Next year, Wynn will open a casino in booming Macao

it much harder for institutional investors to influence his decisions.

Wynn already has his next projects cued up: a \$700 million casino opening next year in the booming Chinese market of Macao and an even more exclusive, \$1.4 billion casino, dubbed Encore, next door to his Las Vegas property. Such high-end resorts rarely earn outside returns. UBS Securities

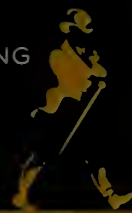
noted in a report last year that the average Las Vegas Strip casino returned just 13% on capital—about what Wynn Las Vegas is projected to earn in 2006. Lower-budget properties such as Mandalay's Excalibur and MGM's New York-New York earn above 20%.

Still, investors, enthralled with surging Vegas tourism and the even hotter Macao market, have bid Wynn shares up fivefold since their initial public offering in October, 2002. At a recent share price of \$68, Wynn's 25% stake is worth nearly \$1.7 billion—six times his investment. Everyone likes to be with a winner. ■

—By Christopher Palmeri in Las Vegas



KEEP WALKING



AFTER THE HOUSING BOOM

What the coming slowdown means
for the economy—and you

BY KATHLEEN MADIGAN



ADMIT IT—YOU'VE DONE IT. YOU'VE SURFED WEB SITES SUCH AS GETMY- homesValue.com and Domania.com to get a sense of the real estate values in your city. On weekends you skim local real estate ads to check asking prices. And at neighborhood dinner parties you steer the conversation to find out what price that four-bedroom colonial down the block fetched when it sold last month.

In today's ownership society, few investments have been so lucrative for so many as homeownership. Since 2001 extremely cheap mortgage rates have fueled a record-setting level of home sales. Frenzied demand caused home prices to jump at rates not seen since the 1980s and generated 10% gains each year in housing wealth for many Americans, who quickly used refinancings or home-equity loans to convert some of the windfall into cash.

MARICOPA, ARIZ.
So far, demand remains strong in the Sunbelt

MIENDA
BUILDERS

Models
Open

HOMES
CANTERRA
Solid Value • Quality Construction

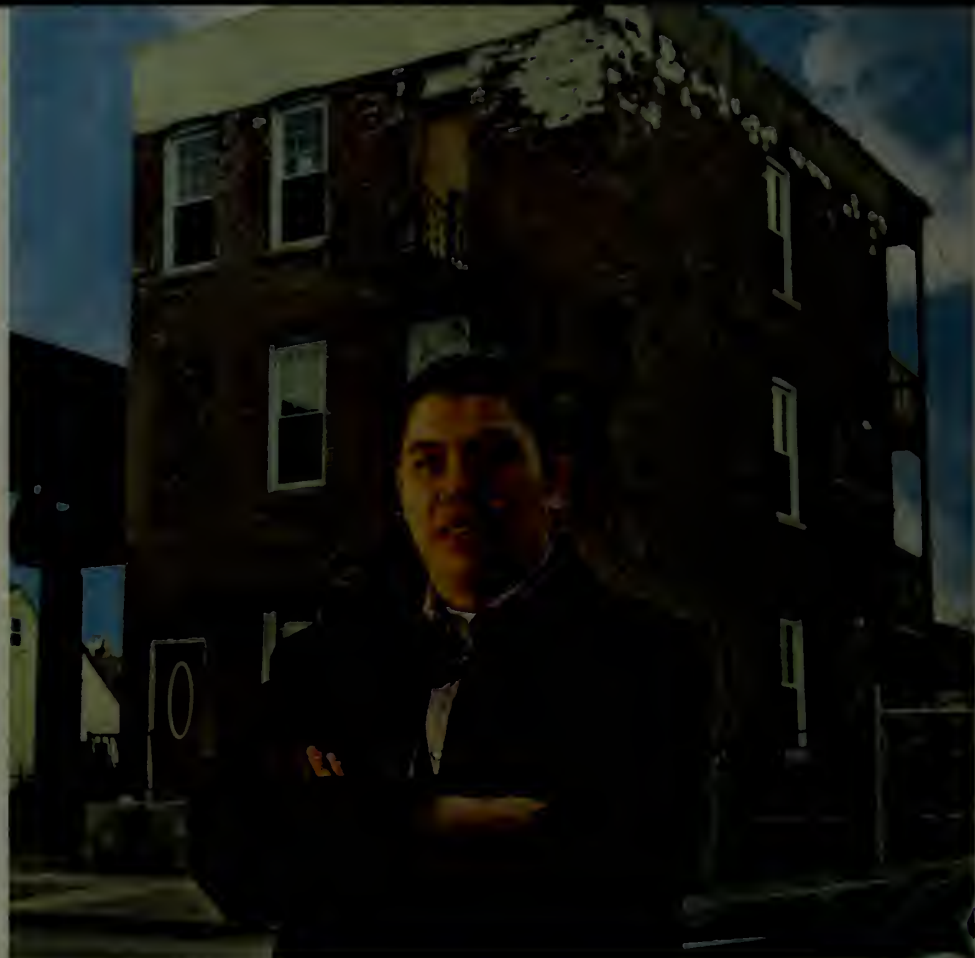
**SALES
OFFICE**



ENGLE
HOMES

**NOW
OPEN**





“I think it's topped out for now.”

—Peter Gonzalez, a homeowner and landlord on Chicago's West Side

With millions of Americans still eager to get into the housing bonanza, it's no wonder signs of overheating are popping up. At building sites from Florida to California, househunters stand in line just for the chance to buy a home. Investors are flipping properties almost overnight. For some lucky folks, home values have doubled in five years. And in early 2005 the boom was in full swing. New-home sales surprised many economists by jumping 9.4% in February, to an annual rate of 1.2 million. And starts rose to a yearly pace of 2.2 million in the month, a level not seen consistently since housing's go-go 1970s.

But hold on. Despite February's strong numbers, 2005 looks to be the year that housing finally cools off. Thanks to tighter monetary policy and a stronger-than-expected economy, mortgage rates are on the rise. In just six weeks, rates have jumped by almost half a percentage point, to over 6%, by Mar. 25. By 2006 they will likely hit 7%. As a result, economists surveyed by *Blue Chip Economic Indicators* see housing starts slipping by about 5% this year and more in 2006. Sales are likely to fall by the same amount. On a national level, home prices aren't going to plunge—they just won't rise very much. “Home prices will rust, not bust, for the next few years,” says Richard Berner, chief U.S. economist for Morgan Stanley.

Housing's slowdown will be relatively mild compared with past downturns, though there are pockets of froth (page 82). Why? It's taking place at a time when the economy is expected to grow by over 3.5%. In the past 40 years, national new-home prices have fallen only twice, and both times were during a recession.

Besides the good job and income growth associated with a healthy economy, there are other compelling reasons that the market won't soften too much. Baby boomers continue to fuel demand—especially for second homes—and immigrants are increasingly becoming first-time home buyers.

Even so, the new reality will have a big impact on home-

owners who have begun to look at 10% annual gains in home values as a birthright. Consumers who made a habit of tapping into their home equity will find that their home is no longer a personal ATM. Anyone counting on continued home appreciation to fund their retirement or pay for their children's education may face a big shortfall when the bills come due. The new ways that housing is financed also shift the risk of rate changes from banks to homeowners. That could squeeze some families who have adjustable-rate mortgages.

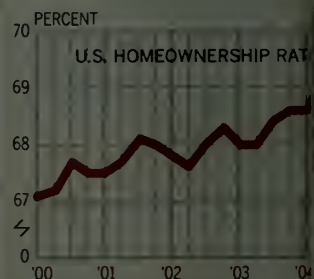
Rising Rates

FOR THE ECONOMY, A SLOWDOWN in home demand and prices could crimp consumer spending. In just three years, from 2002 to 2004, homeowners who refinanced their mortgages took out a phenomenal \$400 billion in extra cash, most of which was pumped back into the economy. That source is going to dry up. The loss will come on top of the eventual soften-

THE PARTY WINDS DOWN

For four years, strong housing activity boosted the economy. Now that support is waning.

With so many already owning homes...





“The whole bubble thing is really overrated.”

—Ryan Brown, who buys and remodels homes in the Los Angeles area

ing in construction activity and mortgage lending, both big sources of employment in this expansion.

A cooler housing market could even have an impact on the ability of the U.S. to finance its enormous current account deficit. Since 2000 foreign investors have poured \$400 billion to \$500 billion into mortgage-backed securities, which seemed safe and attractive. But that money could go elsewhere if the U.S. housing market turns sluggish and fewer mortgages are written.

Of course, predictions that housing is about to peak have been made repeatedly over the past few years. So why does the turn look certain now? “The slowdown is all because of higher rates,” says David A. Lereah, chief economist at the National Association of Realtors. True, mortgage rates have bounced up before—most recently in the summer of 2004—but this time economists expect them to keep rising, in part because of the stronger economy. Plus, inflation has picked up, and not just from higher oil prices. In its last survey of regional business ac-

tivity, the Federal Reserve found that “a number of districts indicated greater ease in passing along price increases.”

Higher borrowing costs are already pricing potential home buyers out of the market. In housing, affordability is determined by monthly payments, including taxes and insurance. Take a home buyer with an income of \$100,000 and a \$40,000 downpayment. At a 30-year fixed-mortgage rate of 5%, the buyer can bid as much as \$421,000 for a home. At a 6% mortgage, that falls to \$390,000. At 7%, the upper limit is only \$362,500. Spread across all income levels, that 13% drop in affordability whittles away at demand and cuts down on bidding wars, which helped drive big price leaps in some areas.

As higher rates dampen demand, the effects will spread to the rest of the economy. In the past three years homebuilding has made an oversize contribution to the growth of real gross domestic product and employment. Residential construction makes up less than 5% of the U.S. economy but accounted for over 12% of average yearly growth since 2002. Similarly, construction jobs tally just over

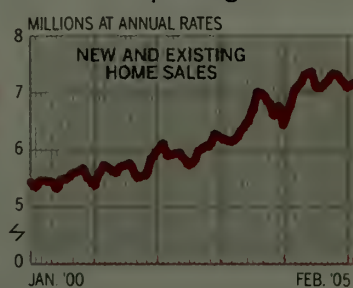
5% of all payrolls, but hiring at building sites has accounted for 16.6% of all new jobs in the past two years.

For 2005 homebuilders are still optimistic about demand. There’s a backlog of unfilled orders for new homes, and Los Angeles-based KB Home, for example, recently raised its fiscal 2005 profit forecast. Ryan Brown is one real-estate investor who remains upbeat. He and his business partner,

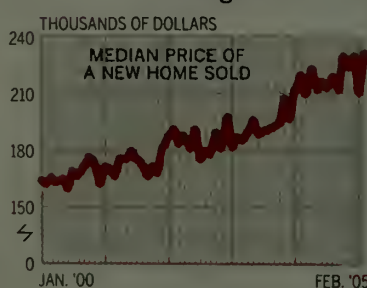
....and mortgage rates rising...



...sales are peaking....



...and prices are leveling off



Census Bureau, National Association of Realtors, Fannie Mae

Jeffrey Lewis, buy and remodel homes in the Los Angeles area. Their latest project is a three-bedroom, three-bath house in the Hollywood Hills that is listed for \$1.49 million. "The whole bubble thing is really overrated," Brown says. Yet even he has reduced his price expectations, figuring appreciation may slow to about 3% or 5%. For the industry as a whole, higher mortgage rates will inevitably cut orders. By 2006 home construction will become a drag on the economy.

More important than housing's direct effect on the economy will be fallout from the slowdown in home-price appreciation. This is where the economy will be most vulnerable. Thanks to the easy availability of refinancings and home-equity loans, consumers have gotten used to tapping into the equity built up in their homes. In a 2002 study the Federal Reserve found that the average household extracted \$26,700 in equity with each refinancing. One-third of that money was used to pay off old debts or add to savings; the other two-thirds was spent. The Fed estimated that the extra spending added a quarter- to a half-percent to consumer spending. That provided a welcome

boost to demand as recession, terrorist attacks, and a sagging stock market were dragging down household purchases.

Now the refi windfall is going away. Freddie Mac forecasts that these cashouts will fall from \$139.2 billion last year to \$95.9 billion in 2005 and \$61.2 billion in 2006. Luckily stronger wage growth will take up some of the slack. But any brake on consumer spending at a time when households are already dealing with ever-higher energy costs will be a big deal given that household demand accounts for two-thirds of the total U.S. economy.

Financing Shift

ASSESSING THE PSYCHOLOGICAL impact on homeowners is more difficult. This time around, price weakness is happening when the economy is strong, and that's highly unusual. "The last time we had outright price declines, we were in recession," notes David W. Berson, chief economist at mortgage lender Fannie Mae. So when it comes to gauging consumer

WHAT'S YOUR HOUSE WORTH NOW?

Is the price of your house about to plummet? There's no one foolproof indicator of a local housing bubble, so the best approach is to evaluate the situation from many angles. It's important to gauge such factors as construction permit issuance, local incomes, job growth, and rental rates to determine if you're living in a danger zone. "You have to triangulate," says Susan M. Wachter, a real estate economist at the Wharton School. By these measures, prime candidates for trouble include such places as San Diego and Los Angeles on one coast and New York and Miami on the other.

One of the best indicators of potential problems is the National Association of Home Builders-Wells Fargo Housing Opportunity Index. This measures the percentage of homes sold in a given area that

are affordable to middle-income families, defined as those with incomes at the midpoint of all families' incomes. The index takes into account property taxes and current interest rates, and assumes that families can afford to spend 28% of their monthly gross income on housing. Certainly, many people in hot markets stretch to spend more than that on housing, but there comes a point where prices are simply too high. By this measure, Los Angeles ranked dead last in the final quarter of 2004, with only 5.2% of area houses affordable by a median-income area family. San Diego was barely better with 5.3% affordable. Other areas that look bad include New York (10.8% affordable), San Francisco (11.6%), and Las Vegas (36.2%). By contrast, middle-income folks could afford 90% of the homes in Buffalo.

By itself, the Housing Opportunity Index

doesn't prove that a bubble has formed or is about to pop. The case for an overinflated market gets stronger if you can rent a nice house for far less than the monthly carrying cost of buying it, including mortgage and maintenance. High price-to-rent ratios mean that people are paying a premium to own rather than rent, presumably because they expect their homes to appreciate and earn capital gains. The bigger the premium, the more unrealistic their expectations are likely to be.

WHEN RENTS LOOK GOOD

San Diego is the most bubble-icious big city by this measure. According to Torto Wheaton Research of Boston, it cost only 40% as much to rent as to own in San Diego last year. The ratio was 45% in San Francisco, 54% in Las Vegas, 55% in Los Angeles, 59% in Washington, and 63% in Miami. In these cities, "It's much better to be a renter than a buyer unless your horizon is longer than five years," says Gleb L. Nechayev, a senior economist at Torto Wheaton.

Still not sure if you're living in a bubble? Then look at the share of houses that are being bought for investment purposes only.

MR. BUBBLE'S NEIGHBORHOOD

While national home prices shouldn't drop much, if at all, some areas are vulnerable to a big decline. Here's why:

POTENTIAL TROUBLE SPOTS

FIVE-YEAR GAIN*

VULNERABILITY

*Based on median price of existing single-family homes, 1999-2004. If the quarter average!

SAN DIEGO

137%

Huge price leaps have driven home values extremely high compared to rents for equivalent properties, a sign of a speculative market

LOS ANGELES

118%

Ranks last nationally in the ability of a middle-income household to buy a midpriced home, according to the National Association of Home Builders (NAHB)

MIAMI

105%

Standard & Poor's says Miami is at risk for a decline based on the area's history of big price fluctuations and the recent runup in home values

confidence, "it's hard to disentangle the job-loss effect from the home-price effect." What does seem certain is that, if prices level off or rise only a bit, owners, especially on both coasts, may feel less wealthy, even though they will not have actually lost money. That could be another drag on consumer demand since studies show about 5.5% of new housing and stock wealth is spent.

Another danger to the household sector has been the proliferation of adjustable-rate or no-money-down loans. These new financing vehicles have enabled more people to buy homes. But the negative effects of rate changes will hit these consumers more than their lenders. Bert Ely, a bank consultant in Alexandria, Va., doesn't see a cause for concern as long as the economy keeps expanding. But he does worry about one thing: If interest rates rise much fur-

ther, the combination of higher payments for adjustable-rate mortgages coupled with rising property taxes from past appreciation could make it difficult for some homeowners to meet their monthly obligations. "We're going to see some people get burned," Ely says.

Banks, though, should avoid most of the suffering. For all of the mortgage frenzy of the past few years, banks aren't carrying more exposure to housing than in past periods. About one-third of banking-industries' assets are in housing-related assets, such as mortgages and home-equity loans. That's the same ratio as in 1995, before the current housing boom. Barbara A. Ryan, associate director in the Federal Deposit Insurance Corp.'s research division, notes that many of the outstanding mortgages have been repackaged into mortgage-backed securities.

The dangers of specula-



SOME LIKE IT HOT
Los Angeles: Most likely to burst?

By this yardstick, Las Vegas looks frothiest among big cities. Of houses bought with mortgage loans last year, 16% were bought just as investments or purchased as second homes, nearly twice the national average of 8.6%, according to data compiled from loan service companies by a San Francisco-based company, LoanPerformance. Phoenix, a market that looks relatively tame by other measures, wasn't far behind Las Vegas at 13%. (The National Association of Realtors reports a much higher national average—23%—but it uses a broader definition of investment property and includes houses bought without mortgage loans.)

Most of the metropolitan areas at the top of the LoanPerformance list are smaller cities—places like Redding, Calif.; Tallahassee, Fla.; and Trenton, N.J.—that look cheap to investors living in big, expensive ones. "These are the markets that make me nervous," says John Burns, president of John Burns Real Estate Consulting Inc. in Irvine, Calif. "That's where the dot-com mentality is going on."

Typically, home prices in most of the country don't rise much above the rate of inflation, because it's easy to increase the housing supply by expanding the suburbs outward. That's why the doubling of prices over the past five years in places like Las Vegas, where the supply did dramatically increase, is so surprising. Eventually, though, market forces are apt to correct the anomaly. From 1999 to 2004, permits for single-family construction in Las Vegas rose 59%, though employment grew by only 23%, according to the homebuilders' association—so the fresh supply should cool off the market. Similarly, in Phoenix permits rose 48%, vs. a 10% employment gain.

ROOM TO GROW

Those cities can grow because they're surrounded by open space. Most of the speculative markets are on the East and

West Coasts, because when demand rises on the coasts, it's harder to create the supply. Population densities are higher, so there's less available land, and local zoning laws are generally tougher. In fact,

despite zooming prices, the number of construction permits actually fell from 1999 to 2004 in many coastal locales—19% in Boston, 23% in New York, and 25% in the San Francisco Bay area.

The flip side is that when demand slackens or supply finally picks up, prices on the coasts can fall as quickly as they rose. That's why Los Angeles and Miami appear fairly high on Standard & Poor's list of areas with the highest risk of a price decline, based on their history of wide price fluctuations and recent price increases. "At some point something has to give," says Francis Parisi, an S&P structured-finance analyst who helped devise the new measure.

Right. And if you're thinking of buying a house in, say, San Diego, what might have to give is your own net worth.

—By Peter Coy in New York

LAS VEGAS

WASHINGTON, D.C.

NEW YORK

SAN FRANCISCO BAY

BOSTON

103%

97%

94%

78%

44%

Jobs rose 23% from through 2004, single-housing permits rose more: 59%. Some homes are being as investments

Purchase prices are very high in comparison to rents, says Torto Wheaton Research, which suggests that buyers expect unrealistically large capital gains

The least-affordable big city east of the Mississippi, based on the level of prices compared to local incomes, according to the NAHB

Prices have soared even though the area's employment has fallen by 7% since 1999

While recent price increases have been relatively restrained, prices are very high in comparison to both local incomes and rents

Data: National Association of Realtors, Bureau of Labor Statistics, National Association of Home Builders, Standard & Poor's, Torto Wheaton Research, LoanPerformance, John Burns Real Estate Consulting Inc.



A black and white photograph showing the front left corner of a Lexus LS. The car's headlight, grille with the Lexus emblem, and side mirror are visible. The background is a plain, light-colored wall.

INTUITIVE CLIMATE CONTROL. THE GREAT EQUALIZER.

When it comes to temperature, the environment outside your car is not always created equal. Which is why we evened the score with our intuitive climate control in the LS. Strategically placed solar and temperature sensors detect hot or cool spots inside, and automatically direct airflow from the vents to those areas. Thereby ensuring a more comfortable ride for you and your passengers. It's yet another way the pursuit of perfection lives from mile to mile. For additional insight on what makes a Lexus a Lexus, please visit lexus.com.

THE PASSIONATE PURSUIT OF PERFECTION



tion, too, have shifted from the building industry to individuals. In past housing booms overly optimistic builders flooded the markets with too many homes built on spec. The result was an oversupply that worsened a downturn, triggered bankruptcies, and caused layoffs among construction workers. Now builders typically wait for a downpayment before breaking ground, so the supply of housing is quite lean compared to sales. The speculation is popping up on the demand side. "In a way we've outsourced building speculation," says Michael Carliner, an economist at the National Association of Home Builders. That means the individuals who bought those properties, and not companies, will bear the pain if price gains or demand don't meet expectations.

SHRINKING PIGGY BANK

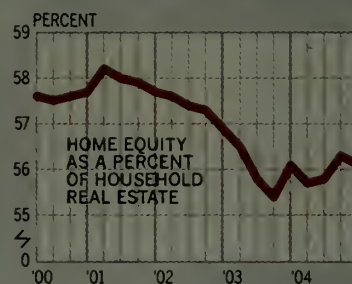
The cash freed up by the refinancing frenzy has buoyed consumer spending. But that source of discretionary income may run dry.

Homeowners have taken advantage of rising prices...



Data: Freddie Mac, Federal Reserve

...but the cooling market means there will be less equity to tap



Still, the pain won't be as bad as in previous slowdowns. In the last big housing recession, in the early 1990s, starts plunged 12.9% in 1990 and 16.2% more in 1991. That's not in today's forecast. And for all the media attention and party chatter about a bubble, there's little evidence that the national housing market is superinflated.

A Chance to Rebalance

CONTRAST TODAY'S HOME MARKET with the economy's last bubble—in tech stocks. In the late 1990s the NASDAQ surged 40% a year as people threw billions of dollars into companies that had no profits or coherent business plans. That's a far cry from 2005's housing picture. The supply of housing has not outstripped demand, and price increases have been supported by gains in jobs and incomes.

And the fundamentals of housing—the health of the economy and demographics—argue against a widespread drop in demand. Faster job and income growth should help to offset the drag of higher borrowing costs. Plus, even though a record 69.1% of Americans owned their homes at the end of 2004, demand will still be supported by baby boomers and immigrants.

Boomers, in particular, are driving the second-home market with an eye toward both investment and future retirement. Debbie Bockhold, a certified public accountant in Orange County, Calif., and her husband, Tim, a stockbroker, plunked down \$450,000 for a new vacation home—a two-bedroom condo just 15 minutes from the Strip in Las Vegas. Does she think she may be taking a gamble on housing in the city of big bets? Not at all. With other Vegas condos going for as high as \$1,000 a square foot, "the price per square foot [\$280] is just a great buy," Bockhold says.

Immigration is another trend that will help housing coast to a soft landing. Morgan Stanley's Berner points out that immigrants accounted for one-third of the new households formed

in the 1990s, and these families are entering the housing market. Peter Gonzalez, a 32-year-old naturalized citizen from Mexico, is a prime example. In December, 2003, he purchased three-unit building in Pilsen, a predominantly Mexican-American neighborhood on Chicago's West Side. He lives in one flat and rents out the other two. With demand for rentals strong, he's looking to raise rents. "I'm going to take the money and either build another rental building on property I already own in Pilsen or purchase and rehab another building," he says. But even he has turned cautious about the local market. "I think it's topped out for now," says Gonzalez.

There is a silver lining from the slowdown. Cooling in markets that benefited most from low rates will bring better balance to the national market as a whole. "People forget," says the Realtors' Lereah. "A housing boom does create haves and have-nots. Not everyone is a have. Detroit and Dallas have seen flat housing markets for several years." Slower price appreciation might make housing more affordable for young families. And builders might appreciate a breathing period that gives them a chance to whittle down their backlogs.

A slowdown in refs and home-equity loans might also address the growing problem of too little savings for baby boomers. Although housing wealth hit a record in the fourth quarter, the large amount of refs over the past half-decade means that equity as percent of real estate stood at just 56.1% (charts). That's far less than the equity ratios of the 1980s and '90s. Boomers expecting to retire on the gains from their homes could face problems if they continue to refinance—ending up with a substantial mortgage at age 65.

For now, homeowners still have faith that housing is a sure thing, even as they've begun to temper their expectations. Multi-homeowner Bockhold sums up the feelings of many: "Real estate's been good for us." And it has been good for the U.S. economy. But with so many families already owning their homes and mortgage rates rising, the party is winding down. Housing is entering a more sober period when it won't be a prime generator of growth. And the phrase "home, sweet home" won't have giant dollar signs attached to it. ■

—With Christopher Palmieri in Los Angeles, Ann Therese Palmer in Chicago, and Dean Foust in Atlanta

More on housing at BusinessWeek.com/extras

You'll find an interactive table that lets you study how more than 30 major metro areas stack up on nine different housing-related measures. You can judge how vulnerable your own market is to a steep price decline using indicators based on prices, construction, jobs, incomes, rental rates, and the share of houses bought for investment purposes.

There's also a guide to help you decide whether you should switch from an adjustable-rate mortgage to a fixed-rate mortgage as the housing market cools and interest rates rise.

BusinessWeek online

<http://www.businessweek.com/extras>



“I was rushed through some paperwork without knowing what was going on.”

—Jeweline Simmons,
East St. Louis, Ill.

THE FED EYES SUBPRIME LOANS

New disclosure rules aim to flush out discriminatory rates

WHEN JEWELINE SIMMONS NEEDED A home-improvement loan in 1999, she went to Shelter Mortgage in East St. Louis, Ill., thinking the broker would get her the lowest interest rate possible. She qualified for a 9.8% rate, but she wasn't told that. Instead, Shelter steered her to loan at 10.7%. Its reward for this tidy piece of salesmanship: \$604.50 payment from lender EquiCredit Corp., according to U.S. District Court documents. "I was rushed through some paperwork without knowing what was going on," Simmons says. Only after she had fallen behind on payments and contacted a lawyer did she learn that she was paying too much. She sued Shelter and EquiCredit, which couldn't be reached for comment, and settled out of court.

Battles over lending to low-income, often minority, home buyers used to be about access to credit. Now they're about access to affordable credit. "It's not whether you get the loan, it's the price of the loan," says Kevin Stein, associate director of the California Reinvestment Coalition, an advocacy

group. Over the past decade lenders have devised ways to grant mortgages to millions of people with poor credit who wouldn't have qualified before, driving U.S. home ownership to record levels. But those borrowers pay higher rates to compensate lenders for taking on more risk. As the value of these so-called subprime loans has nearly quadrupled since 2000, critics have questioned whether the high rates are justified.

The Federal Reserve wants answers. It has long required lenders to disclose the race, gender, and neighborhood of borrowers to anyone who asks. Now it is upping the ante. As of Mar. 31 lenders must also disclose the interest rate charged on each mortgage if it is three percentage points or more higher than the yield on Treasury bonds, or five points higher for second mortgages. This will help researchers see "if, in fact, differences in rates are truly driven by differences in risks and costs and not tainted by discrimination," said Fed Chairman Alan Greenspan in a speech on Mar. 11.

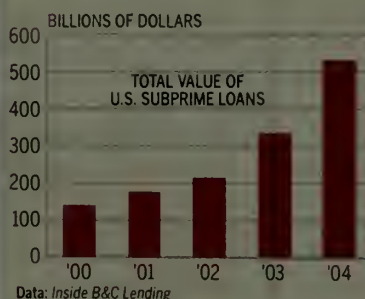
Ignoring the Scores?

THE DATA WILL ADD FUEL to an already fiery debate. Advocacy groups are expected to seize upon the new numbers as more evidence that lenders rip off low-income home buyers, even if they don't actively discriminate against them. Critics point to a 2004 study by Freddie Mac showing that 38% of subprime borrowers in 2001 had credit scores that qualified them for a prime rate. The study didn't look at the other variables that determine rates. Freddie Mac believes the percentage of subprime customers who should have received prime-rate loans is probably no higher than the low teens.

Lenders are bracing for a public relations onslaught. They argue that their computerized, color-blind models price the risk of each mortgage as accurately as possible. "The data [that have been made public] don't take

BOOMING BUSINESS

Mortgage lending to borrowers with poor credit is soaring



into account all the factors that go into making a pricing decision on a mortgage loan," says Anne C. Canfield, executive director of the Consumer Mortgage Coalition, an industry group. Lenders argue that disclosing credit scores, income-to-debt ratios, and other details would compromise their customers' privacy and reveal proprietary underwriting methods.

Legislatures and law enforcement aren't waiting for the new data. Since 1999 some 31 states have reined in the subprime-loan market by measures that ban prepayment penalties and restrict the repeated refinancing of loans with ever-higher rates and fees. In Congress two recent bills seek to set national subprime lending standards (BW—Apr. 4). On Feb. 23 the nation's largest subprime lender, Orange (Calif.)'s Ameriquest Mortgage Co., said it is "in discussions" with authorities in 25 states over its lending practices. The company declines to comment further.

Big Players

CLOSER SCRUTINY hasn't discouraged some of the country's biggest banks from getting into the fast-growing business, long the exclusive province of specialized subprime lenders. Citigroup ranked eighth in issuing subprime mortgages last year, according to newsletter *Inside B&C Lending*. Also in the top 20 were JPMorgan Chase, Wells Fargo, and Washington Mutual. The attraction: profit margins that are still slightly better than those on prime loans because of inefficiencies in the market, says Doug Duncan, chief economist at the Mortgage Bankers Assn. Subprime lending "is not a perfect market, but it's getting more efficient," he says, thanks to competition and better models.

The discretion mortgage brokers and lenders have in setting rates and fees leads to inefficiencies. Lenders offer brokers, who handle about 65% of mortgages, incentive payments to send high-priced loans their way. "When the broker is compensated on the price of the loan, he has an incentive to squeeze the highest interest rate he can get away with," says Ruhi Maker, a senior attorney at the Public Interest Law Office of Rochester, N.Y.

That's just the kind of problem the Fed aims to understand with the new disclosure rules. If the data hint at unfair pricing, lenders may have to take a good, hard look at their methods. ■

—By Justin Hibbard in San Mateo, Calif.

Picking Up Where Search Leaves Off

The time-saving trend of "tagging" is luring legions of Web surfers—and Yahoo!

JOSHUA SCHACHTER USED to be a lot like the rest of us online. When he surfed the Web, he'd zip through interesting articles only to find that days later he couldn't remember where he had seen the stories or sites that had caught his interest. Unlike most of us, though, the 30-year-old New Yorker is a software programmer—so he did something about this lapse in memory. A little over two years ago, Schachter created a program that let him tag Web links using words he would remember and then store them for easy access. So when Schachter saw a story about, say, the music videos of Icelandic singer Bjork, he would slap a "music" tag on it and file it away.

At the end of 2003, Schachter opened a Web site, del.icio.us, to let anyone use the technology. With del.icio.us, people are able to tag any link they choose for easy retrieval later. What makes tags more powerful than a Web bookmark is that they can be shared easily with other people. If someone tags a story on Iraq, for example, that link is added to a list on del.icio.us of other Iraq content. Anyone on the service who wants to read about Iraq can then find a list of stories

that have been tagged and see who tagged them. Today more than 85,000 people are using the free service. "Tagging is about the most important tool of last year," says Clay Shirky, an adjunct professor at New York University's Interactive Telecommunications Program.

Indeed, the practice is catching on fast. The blog index Technorati Inc. and corporate portal developer Plumtree Software Inc. are adopting the technology. Amazon.com Inc. announced in February an investment in tagging startup

Tagging 101

Tags are labels that people can slap on photos, articles, and videos on the Net. Here's how they work at pioneer del.icio.us:

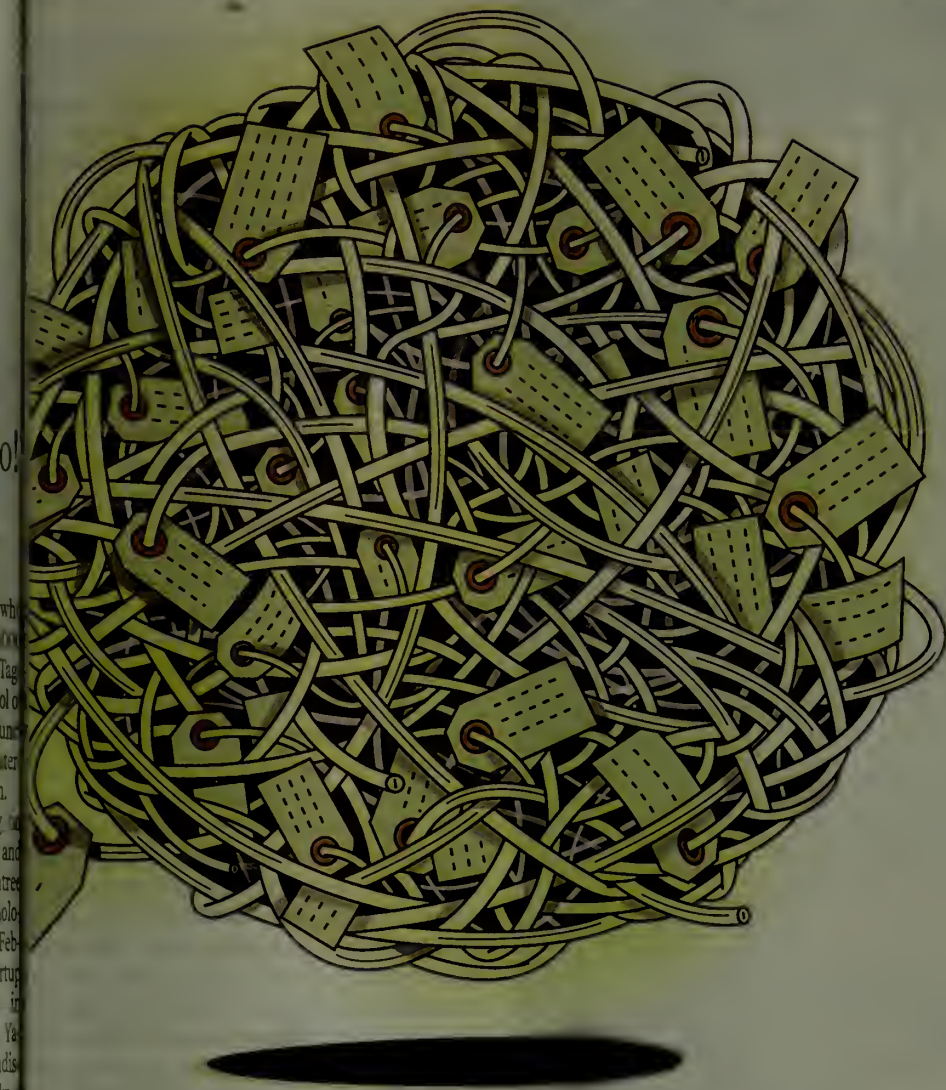
1 A del.icio.us user visits the site of, say, SomaFM, an indie Web radio station. The user saves the link to a personal area of del.icio.us with the tag "radio."

2 At the same time, the link is added to the overall del.icio.us service, where other users can see it.

3 Another del.icio.us user finds the link while browsing the "radio" tags. The user saves the entry to his personal area, adding his own labels to describe the station's music, such as "trance" and "techno." It now appears on del.icio.us under those tags as well.

43 Things. And in March, Net giant Yahoo! Inc. paid an undisclosed sum for Flickr, a year-old photo-sharing service that attributes its success in luring 420,000 subscribers to its use of tagging. While Yahoo won't discuss specific plans, it's expected to sprinkle tagging throughout its Web properties. "I hope [Flickr's co-founders] become part of our vanguard to help us as we venture boldly and somewhat blindly into this [new world]," says Jerry Yang, co-founder of Yahoo.

There's a good reason Yahoo is taking tagging seriously. The trend represents a new approach to organizing and finding information online, and industry watchers expect it to draw people away from the traditional Net



search offered by Yahoo and Google Inc. tagging won't replace Google et al. But people may turn to tags more frequently over time, reducing their use of established search engines.

The risk? It could cut into the search-advertising revenues that are all-important to Google and Yahoo. No one has estimated the potential toll, but losing even a few minutes of people's time each day could be costly. "Search is no longer the only way to find things," says Howard Rheingold, author of *Smart Mobs: The Next Social Revolution*.

Search engines, for all their advances in recent years, have a glaring drawback: No matter how many pages they index or how quickly they bring back results, they can't put those results into context. They can find a specific word, but they can't figure out what the word means. An example: Look up the word "python" on Google, and the list of results throws together sites about the reptile, the programming language, even Monty Python. You have to sift through pages of irrelevant results to find what you want. To help avoid the confusion, Web sites

often manually label their pages with category titles, a version of tags called metadata. But mass search engines, such as Google, don't use metadata because they can contain spam or misleading descriptions.

A "LAYER OF SOCIAL KNOWLEDGE"

TAGGING, HOWEVER, LACKS the algorithmic wizardry of search engines. But it lets people work together organically to create the context traditional search typically misses. Blogger Thomas Vander Wal coined the word "folksonomy," a combination of the words folk and taxonomy, to describe this joint work. It's like a grassroots Dewey Decimal Classification System for the Web. The essence: The combined work of people busily tagging content creates another way to make sense of the mountains of information online.

People are using tags to share their work and their whimsies. At del.icio.us, groups are adopting specific tags to help them collaborate on projects. For instance, in January a group of bloggers interested in applying technology to nonprofit groups adopted the "NPTEch" tag.

They file links to that tag, creating a bibliography of research that contains more than 900 articles, Web links, and blog posts. At Flickr, individuals often create a tag meant to inspire others to take and share photos. An example: Under the "What's in your bag?" label, users have posted photos of the contents of computer bags, knapsacks, and purses. "What has me really excited is this layer of social knowledge that's being created," says David Weinberger, a fellow at Harvard University's Berkman Center for Internet & Society. "We can't even anticipate yet what kind of research we will be able to do or the services that will develop."

The rising popularity of tagging is spurring debate about potential problems. Already, spam is being posted within tags at Technorati. Flickr and Technorati use a combination of automatic filtering and manual removal to combat these early marketing attempts. Still, if spam can't be held in check, it will undermine the usefulness of tags. "Every healthy ecosystem has parasites," says David L. Sifry, founder and CEO of Technorati. "We're trying to take into account what we learned from e-mail spam."

Another worry is whether tagging could collapse under its own weight because it isn't a standardized system created by professionals. In the free-flowing tagging world, one person might apply the tag "camera phone" to photos taken with a mobile phone, while someone else uses the words "mobile phone," undermining the whole point of sharing valued information. People also might use overly broad words as tags, say, Paris or wireless, resulting in too much information to plow through.

Tagging proponents such as Shirky maintain that no one company can afford the cost of applying standard tags to everything on the Web—that only many individuals tagging every day could help structure the vast reaches of Net content. And these individuals and businesses are devising ways to make it easier to find just the right information via tags. For instance, Technorati recently copied Flickr in offering lists of related tags when someone does a search on a generic one. So while tagging may look unorganized, there is logic to this avalanche of virtual Post-its.

People are providing their own likes and dislikes as guideposts to help others pick their way through cyberspace. Tagging is bringing a new kind of order to the chaos of the Web. ■

—By Heather Green in New York, with Robert D. Hof in Scottsdale, Ariz.

Only Making It Worse

Purcell's moves at Morgan Stanley may be about self-protection, not performance



BOARD-BACKED
But now, Purcell may have put the company in play

IT WAS A HUMILIATING DAY FOR Morgan Stanley, one of Wall Street's most prestigious investment banks. By Mar. 30, just two days after Chairman and Chief Executive Philip J. Purcell named two new co-presidents to usher in a "new generation of leaders," several key executives had abruptly resigned. Some research analysts issued reports saying Purcell's own departure would boost the firm's stock price. And former Morgan Stanley top guns attacked Purcell on national television. CNBC even conducted an informal poll asking viewers if they thought Purcell should be fired; 84% of respondents said yes.

As the heat intensifies, Purcell is only making matters worse. His abrupt decision to reshuffle top management has backfired, leading to new criticism of his leadership. He had already faced a torrent of complaints from investors and former senior managers for damaging Morgan Stanley's performance by mismanaging its retail brokerage and Discover credit card operations—both drags on the bank's performance. Instead of addressing those concerns, Purcell has driven away two of the leaders of the firm's crown jewel—and the source of nearly two-thirds of its operating profits—the investment banking division. His action may even put the company in play. Says Richard X. Bove, a financial-services analyst at New York investment bank Puck Ziegel & Co.: "This fight may have gone too far. Humpty Dumpty [has fallen] off the wall."

For now rivals are itching to take advantage of Morgan Stanley's weakness. Analysts say it's a great time to call Morgan's top-drawer clients to try to persuade them to jump ship. Already phones at the firm are ringing off the hook as headhunters and competitors trawl for talented—and well-connected—investment bankers in an effort to lure them away, too.

Purcell has managed to stop some of the bleeding. He has persuaded some of his heaviest hitters to stay aboard. Legendary dealmaker Joseph R. Perella, who was promoted to vice-chairman on Mar. 29, says he isn't going anywhere. At a company meeting, Perella said he's sorry two of his "blood brothers" are leaving but he is sticking with the "best team on Wall Street." Perella denies rumors that he resigned and Purcell wooed him back with a promotion. That "is totally wrong," Perella told *BusinessWeek*. "I love Morgan Stanley. I work at Morgan Stanley. Period. Full stop."

While Purcell publicly insists that Morgan Stanley's board of directors—any of them longtime associates of the 57-year-old CEO—backs him unanimously, pressure is beginning to build for Purcell to be ousted. "We would like the board to move quickly to replace Purcell," says former Morgan Stanley President Robert G. Scott, one of eight former senior executives who wrote to the board on Mar. 3 to complain about his poor leadership. The board of directors, says Scott, should "understand that we're not going to go away." Some outside observers have an even more brutal take on the situation. Says David A. Hendler, a financial analyst at New York's Credit-lytics Inc., an independent research outfit: "Purcell is on his last legs."

TAKEOVER TIME?

IT MIGHT BE THE FIRM in its present form. The scuttlebutt on Wall Street is that Morgan Stanley is sliding dangerously close to being put in play. A takeover by the likes of Citigroup, JPMorgan Chase, or Bank of America might be a distant prospect for now. But Wall Street veterans say there is a real possibility that private buyout firms and hedge funds could band together to buy the firm and sell off the pieces. Keefe, Bruyette & Woods Inc. analyst Lauren Smith estimates that Morgan Stanley has a breakup value of about \$67.50 per share, vs. a Mar. 30 closing price of \$55.28. These culture buyers could, for example, sell the retail brokerage, credit-card operations, and asset-management unit—which are together worth \$20 billion or more—and keep the highly profitable investment bank. That's what many of Purcell's critics would like him to do anyway.

Purcell, of course, disagrees profoundly. He wants to keep the whole operation together and insists that his management changes will fix the firm's problems. Morgan Stanley spokesman Raymond O'Rourke says the board met several times, including sessions without Purcell, to discuss concerns raised by the eight former executives in their letter. They also discussed issues raised in December by former Morgan Stanley Managing Director Scott Sippelle. The

board unanimously concluded that proposals to sack Purcell or to break up Morgan Stanley were not in the firm's best interest. The board also approved Purcell's selection of its chief administrative officer, Stephen S. Crawford, 40, and its head of fixed income, Zoe Cruz, 50, to lead the firm as co-presidents, pushing aside Stephan F. Newhouse. "The board has heard, considered, and rejected the opinions from Mr. Sippelle and from the group of eight advisory directors," says O'Rourke. "They have unanimously affirmed their support for management and the strategy for taking the company forward."

Purcell remains unapologetic about his management choices. He told the firm's managing directors on Mar. 29 that he selected Crawford primarily because of his broad experience and strong feel for the rapidly changing global regulatory environment. Purcell chose Cruz for her solid record in running the firm's fixed-income business, one of Morgan Stanley's most profitable units.

Still, a widespread impression is intensifying that Purcell may be more concerned about holding on to his own job than he is about improving Morgan Stanley. Insiders and competitors alike say Purcell forced out the president of the firm's investment bank, Vikram S. Pandit, and the head of its equities division, John P. Havens, to fend off an attempted "coup" they allegedly supported. In the Mar. 3 letter, the eight former Morgan Stanley execs called for Purcell's removal. In the letter they said they feared Purcell might react by trying to "reassign or remove" senior executives in the investment bank. Through a spokesman, the group denies that it is attempting a "coup" and that Pandit or Havens are involved. Neither could be reached for comment.



RIVAL? Insiders say investment bank head Pandit was forced out

Some analysts and veterans say Purcell could become Wall Street's version of Walt Disney Co.'s Michael D. Eisner. Like Eisner, Purcell has an extremely loyal board. It backed him when a power struggle resulted in the departure of former President John J. Mack in 2001. Then it remained silent when Purcell stripped former President Scott of most of his responsibilities in 2003, resulting in his rapid exit. Still, if investors, employees, and clients lose confidence in Purcell, the board may have to take action. David Trone, a financial-services analyst at New York investment bank Fox-Pitt, Kelton Inc., says it's not a foregone conclusion that Purcell will be pressured to step down from the chief executive post, "but we're certainly heading down that path."

Now it's time for Purcell to win over his troops, if he can. The weak performance of Morgan Stanley's stock has revived tensions brought on by the 1997 merger of Morgan Stanley and Dean Witter, in large part because Purcell has failed to win the respect of many of the firm's bankers. Insiders say tensions were mounting between Pandit and Purcell over the past several months. By passing over Pandit, insiders say Purcell has made it clear that he demands loyalty from his employees. But it remains to be seen if he or his new co-presidents will get it.

Add it all up, and Purcell has created a raft of new credibility issues for both himself and for Morgan Stanley. One optimistic analyst forecast that the barrage of criticism could spur the firm to pull together and prove its critics wrong. Whether or not Purcell remains CEO is an open question. He certainly needs to convince more people than those on his friendly board that he can run a world-class investment bank. ■

—By Emily Thornton, with Mara Der Hovanesian, in New York, and with Stanley Reed in London

Purcell's Dilemma

Eight years after Purcell's retail brokerage, Dean Witter, bought Morgan Stanley, the investment bank still accounts for nearly two-thirds of the firm's earnings

DIVISION	Investment Banking	Credit Cards Services	Asset Management	Retail Brokerage Group
SHARE OF OPERATING PROFITS*	62%	19%	13%	6%

*Fourth quarter 2004 Data: Morgan Stanley

Northern Trust's New Wanderlust

The Chicago bank is vastly expanding its international focus. So far, it's paying off

DURING MOST OF A long history stretching back to the Gilded Age, Northern Trust Corp. was content to focus on the U.S. One of the nation's premier money managers for wealthy individuals, the Chicago bank has some 20% of the nation's richest families as clients. It's hush-hush about exactly who banks there, though President George W. Bush's tax returns indicate he does.

But when Northern Trust closed a \$500 million purchase of the financial-services arm of London's Baring Asset Management in late March, the bank completed a long transition from quiet Midwestern firm to global player. On Mar. 22, it got approval to open a Beijing office, its first in mainland China. Northern is now the world's ninth-largest money manager and custodian of more than \$1 trillion in overseas pension, government, and other institutional funds. "We've evolved from a U.S.-centric organization into a global one with a big domestic business," says Chairman and Chief Executive William A. Osborn.

Northern had little choice but to go global. As its biggest corporate customers, such as IBM and Ford Motor Co., expanded overseas, the bank needed to follow, or risk losing them. Meanwhile, fierce competition with domestic competitors such as State Street, Bank of New York, and JPMorgan Chase made going abroad very attractive. With parts of Northern's U.S. business



maturing, says Chris Perry of Turner Investment Partners, "international expansion is very important."

Founded in 1889 in a one-room office in the Loop, Northern started by managing money for prosperous farmers and other members of Chicago's growing upper class. Retailer Marshall Field and meatpacking magnate Philip D. Armour were early clients. While many banks shuttered their doors during the Depression, Northern flourished, thanks to its longtime cautious philosophy. That conservatism isn't lost on the 56-year-old Osborn, an

OSBORN Corporate customers headed overseas. What to do but follow?

Indiana native who joined the company in 1970, a year before Northern's stock began trading on NASDAQ, and took the helm in 1995. Indeed, it underscores his strategy as Northern expands abroad.

While some banks have tried to be things to all customers and stumbled, Northern's international strategy has been more focused. Osborn didn't try to replicate the bank's entire U.S. business. Rather, he targeted institutional and corporate clients and decided to wait before going after the ultra-rich in Europe and Asia, even though managing money for high-net-worth Americans generate about half of its \$1.3 billion in trust fees.

So far, the gambit is paying off. At the beginning of the 1990s, Northern's international business barely merited a footnote in the annual report. But after the Baring deal, it will account for roughly one-third of revenue. And it's a big boost to the bottom line, which last year totaled \$50 million on \$2.3 billion in revenue. Foreign profits are expected to rise 15% a year, compared with 9% to 10% for the domestic operation over the next three years, according to Mark Fitzgibbon of research firm Sandler O'Neill & Partners.

ROUGH CROSSINGS

THE BARING PURCHASE will re-up Northern's capabilities in hedge-fund, private-equity, and real estate administration—three hot growth areas where Northern was lacking. "They've really tried to establish a brand equity that's as strong internationally as it is here in the U.S.," says Jason J. Tyler of Ariel Capital Management.

That reputation may ultimately help get the private banking arm up and running overseas. Still, U.S. banks have had a tough time with wealth management abroad. Authorities in Japan gave Citigroup's private bank the boot last year after a series of regulatory problems. Merrill Lynch & Co. began expanding its private bank in Europe in the late 1990s but then scaled back because growth was hard to come by. Indeed, some think Northern's private bank won't translate overseas.

Nonetheless, it would be wrong to be against Northern as it strives to make its mark in the world. Osborn's methodical strategy may sound boring. But it has also been the key to the bank's long-term success. And with a 116-year history, Northern is sticking with what works. ■

—By Adrienne Carter in Chicago

THE STAT

\$572
Billion

Worldwide assets under management*, up 89% since 2002

*As of Dec. 31

Data: Northern Trust Corp.

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Y BURT HELM

he American Physical Society held its annual March meeting in Los Angeles the week of Mar. 21. As usual, it was a monster gathering, with some 6,300 talks ranging from hydrogen energy to bioengineering and new forms of steel. Here are some highlights:

INNOVATIONS

Cellular chess and the why of splash

▶▶ In physicist Robert Vestervelt's lab at Harvard University, researchers play a kind of chess with individual cells. The cells are tagged with micron-size magnetic beads. Then they're floated in fluid above a grid of computer-controlled magnetic coils. The cells are moved by clicking on the computer screen to turn the coils on and off. One goal of this chess game is to find the best pattern of moves for assembling the cells into an artificial skin.



▶▶ What makes a droplet splash? Lei Xu at the University of Chicago says it's partly the density of the surrounding air. Reduce the air pressure to four-fifths of normal, and a drop of alcohol will flatten smoothly as it lands on dry glass—no splash whatsoever. Understanding this might help reduce splashing in high-end inkjet printing, among other things.

BATTERIES

FIXING THE FLOW IN FUEL CELLS

FUEL CELLS promise up to a tenfold boost in battery life in laptops, cell phones, and the like. But they're expensive, especially the membrane. It's the magic component that produces electricity by separating electrons from a hydrogen-rich fuel such as methane.

Now, a University of Illinois group has built a membrane-free alkaline fuel cell. Its design is sheer simplicity: Just pipe methanol and oxygenated water alongside each other, so a chemical reaction at the parallel surfaces can liberate electrons. What stops the methanol and water from mixing and upsetting the



process? It's called laminar flow. The two liquids emerge from a Y-shaped conduit and meet in a center channel so narrow—roughly 1 millimeter wide—that each liquid's surface tension keeps it intact. "It's like Aquafresh toothpaste," says team leader Paul Kenis, a chemical engineer. A prototype may be ready in three years.

AIRPORT SECURITY SCANNERS THAT CAN SAVE YOUR SKIN

THOSE GATES at the airport aren't terribly secure. X-ray systems that inspect luggage aren't safe to use on people. Even if they were, they might not spot plastic explosives. And magnetic gateways that do screen passengers can't detect a ceramic knife.

So-called terahertz rays can find both, even in a shoe's sole or heel. T-rays, which lie between microwaves and infrared light on the electromagnetic spectrum, see through fabrics and



NANOTECHNOLOGY

HOW MANY ZEPTOGRAMS DOES THAT THING WEIGH?

A TUNING FORK'S pitch depends on the size of its tines. With really tiny tines, you can figuratively play molecular music—as a team from the California Institute of Technology has done. Physicist Jack Ya-Tang Yang told the APS meeting that the team has weighed an extremely small mass—just a few dozen xenon atoms—spraying them on silicon-carbide tines a mere 100 nanometers long. The added weight noticeably slows the tines' vibrations, and the mass that was applied is then calculated from the frequency change. So how few atoms can the tuning fork weigh? About 30, or a mass of seven zeptograms (seven trillionths of a nanogram). Detecting such minuscule quantities is essential for drug research, toxin detection, and more.

leather but don't penetrate or harm human tissues.

Two companies, Picometrix in Ann Arbor, Mich., and TeraView in Cambridge, England, are trying to develop a terahertz people scanner. Currently, T-ray images are extremely grainy and need extra processing to produce sharp pictures. Still, T-rays do have a fast-alarm capability. When they hit a certain type of matter—say, plastic explosives—a specific wave pattern bounces back. Such spectral signatures, TeraView says, can quickly determine if a suspicious material is present, and further processing could pinpoint its location.

(CLOCKWISE FROM LEFT) PHOTOGRAPHS BY WILLIAM SWARTZ/INDEX STOCK; COURTESY KWAME ROSS; COURTESY DR. COLIN BAKER

Can Alcoholism Be Treated?

Research shows how stubborn addictions are—and how medications may help

DR. OLIVIER AMEISEN IS a 51-year-old pediatric cardiologist in Paris. He is also an alcoholic. Between 1997 and 2004, Ameisen was hospitalized numerous times for drinking. He went through years of rehabilitation programs and attended two Alcoholics Anonymous meetings a day, some 700 a year, for seven years. All to no avail. His craving for drink always overwhelmed his desire to quit.

By January, 2004, Ameisen came to believe his only hope would be a drug that could dampen those cravings. But despite the fact that alcoholism is widely recognized as a medical condition, there were only two medications available, and neither had worked for him. Ameisen researched the literature and came across rat studies showing that baclofen, a generic drug used to control muscle spasms, could suppress the desire to consume alcohol by interfering with the reward circuitry in the brain. It is also used to treat anxiety disorders, which afflict large numbers of alcoholics, including Ameisen.

The doctor decided to self-prescribe the drug at high doses. And he took the unusual step of writing himself up as a case study this past December in the journal *Alcohol & Alcoholism*. After nine months on baclofen, he reported that he had not had a drink since Jan. 9, 2004, and, more important, that he had experienced “no craving or desire for alcohol for the first time in my alcoholic life. Even in a restaurant with friends, I was indifferent to people drinking. This had never occurred before.”

Ameisen's detailed report adds to a growing body of evidence that alcoholism—and addiction itself—has unique pathologic traits that can be corrected

through chemical intervention. Drug researchers are now striving to bring science to bear on what was long treated as a social problem rather than a medical one. Over the last decade, sophisticated brain-imaging technologies have demonstrated that constant use of alcohol significantly alters the structure of the brain in ways that can last for months and even

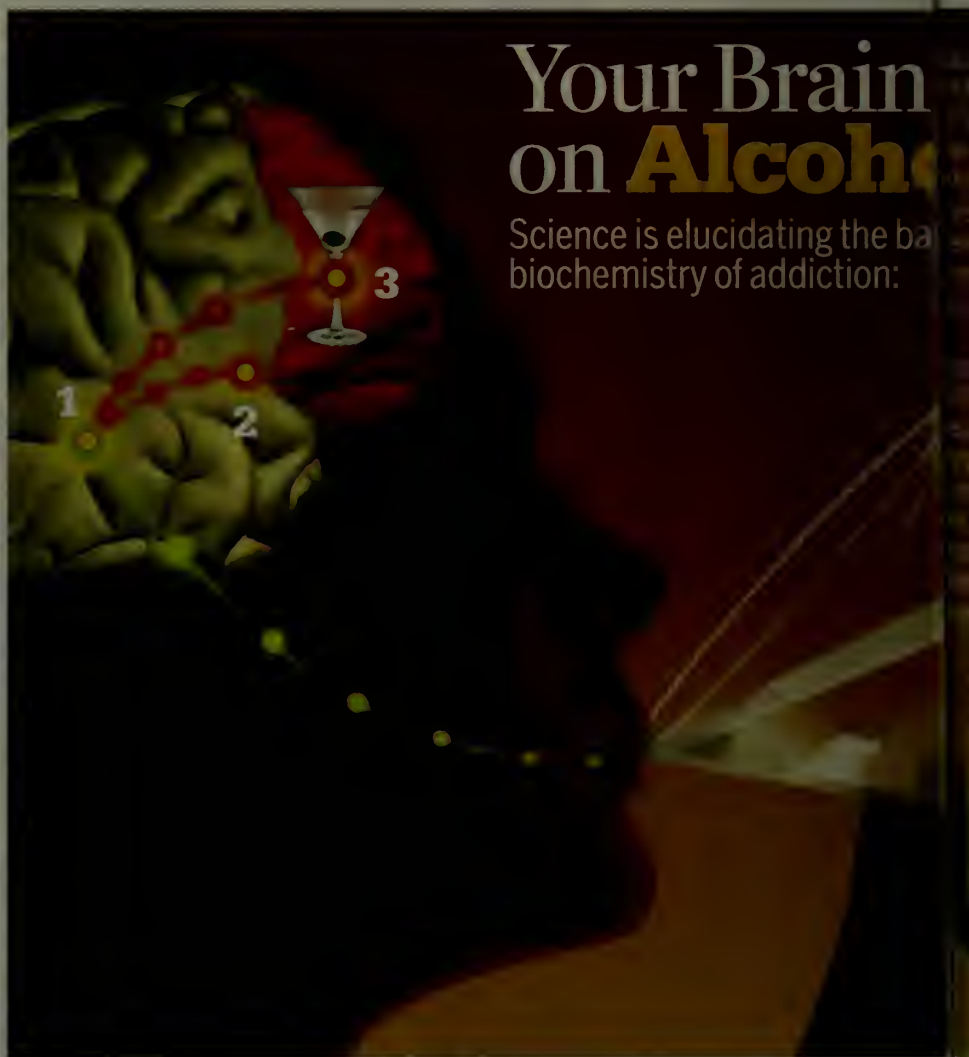
years, creating a chronic brain disorder. With this knowledge in hand, the search is on for drugs that can restore the brain to its pre-drinking state.

Forest Laboratories Inc. started marketing one promising medicine in the U.S. in January. Campral, the first alcoholism drug to win Food & Drug Administration approval in 10 years, is designed to suppress alcohol cravings by targeting specific brain chemicals thrown out of balance by drinking. Alkermes Inc. is to seek FDA approval for its own craving drug, Vivitrex, later this year.

CONVERGING FORCES

NEITHER DRUG IS new. Campral has been on the market in Europe for 10 years, and Vivitrex is a once-a-month injectable form of naltrexone, a daily pill approved for alcoholism in 1994. Neither Campral and Vivitrex miracle cures. Ameisen tried both, to no effect. Clinical trials have shown that they can help patients remain abstinent two to three times longer than those on placebo, but the relapse rate is high.

Still, these medicines prove the principle.



Your Brain on Alcohol

Science is elucidating the biochemical of addiction:

Drugs that target the brain's addiction pathways can curb drinking. Scientists have also discovered that almost any addiction, be it alcohol, cocaine, nicotine, or even gambling, involves many of the same pathways. A drug that treats one addiction may be effective against others. As a result, research in this field is rapidly accelerating. "I've been treating addiction for over 20 years, and for the first time I believe there is a convergence of various forces that will get medications out there," says Dr. Richard N. Rosenthal, chairman of the Psychiatry Dept. at St. Luke's-Roosevelt Hospital Center in New York. "The pharmaceutical industry is finally getting interested."

Drug companies have good reason to pay attention—alcoholism is one of medicine's largest unmet needs. The National Institute on Drug Abuse estimates that almost 18 million people in the U.S. abuse or are addicted to alcohol. They cost the nation some \$185 billion a year in medical services, lost wages, and law enforcement resources. Yet each year only two million alcohol-dependent people seek treatment, and up to 90%

Alcohol, like all addictive substances, goes deep to the center of the brain and stimulates the release of messenger chemicals that activate pleasure receptors in the parts of the brain that control behavior and learning. Alcohol releases GABA, a neurotransmitter that produces feelings of euphoria but can also impair judgment and control. Glutamate, a stimulant, is also released to counterbalance the effects of GABA.

Glutamate also floods those parts of the brain that control learning and memory. The brain tries to resist this oversupply of glutamate by changing the structure of certain receptors. But repeated alcohol use overcomes this resistance, causing tolerance. When the alcohol is withdrawn, glutamate remains at high levels and the brain becomes agitated, leading to severe withdrawal symptoms.

3 Over the long term, the high levels of glutamate and GABA create deeply embedded memories of drinking. These memories lead to cravings triggered by a person, place, or smell associated with alcohol use, and can cause an alcoholic to relapse years after kicking the habit.

relapse within four years.

Despite the huge number of sufferers, alcoholism was "underscenced" for years, says Alkermes CEO Richard F. Pops. Since 1935, when Alcoholics Anonymous was founded, the vast majority of treatment efforts in the U.S. were based on AA's 12-step program, requiring behavioral changes and faith in a higher power. "The history of treatment in this country was not consistent with the idea that medicines could help," says Dr. Klye M. Kampman, associate professor of psychiatry at the University of Pennsylvania. "We were very moralistic."

For decades the only alcoholism drug in the U.S. was Antabuse, which causes people to vomit when they drink. Even now, only some 140,000 alcoholics in the U.S. receive medication for their disease, ranging from Antabuse to anti-depressants to anti-seizure drugs. There was no move to introduce Campral in the U.S. until Forest licensed it from Germany's Merck in 2001.

A clearer understanding of the biological underpinnings of alcoholism is opening the way to better drugs. Scientists have identified a number of genes that confer a predisposition to alcohol addiction. They have also found that the brain goes through profound changes when a person starts drinking to excess.

Alcohol releases a neurotransmitter called GABA (gamma-aminobutyric acid), instrumental in creating a sense of euphoria. Too much GABA can impair muscle control and slow reaction times, so the brain releases a stimulating chemical called glutamate to keep it in check. When alcohol is cut off, glutamate levels remain high and can cause irritability and discomfort. To relieve those feelings, the brain craves another drink. As more GABA and glutamate are released, brain cells change their structure to accommodate the excess chemicals, making them dependent on these levels. When alcohol is withdrawn, painful emotional and physical reactions are set off.

GABA may be the reason people drink, but glutamate is the reason they can't stop. This powerful neurotransmitter is a key player in the brain's learning centers, and excess amounts create deeply embedded memories of drinking. Years after a person quits, these memories can be triggered by a place, person, or even smell associated with drinking, setting off intense cravings. Such cue-induced crav-

Pharma is waking up to a huge unmet need for addiction treatment

ings are the main reason for relapse. "They're why it can be easy to get off a drug, but it's very hard to stay off," says Dr. Herbert D. Kleber, director of the division on substance abuse at Columbia University.

Campral helps alcoholics resist these cravings by checking production of glutamate, bringing the brain's chemistry back into bal-

ance. Clinical studies of Campral have shown that after six months of treatment, 36% of patients were still abstinent, compared with 23.4% on placebo. Vivitrex dampens cravings by a slightly different mechanism, calming opioid receptors in the neurons that are overstimulated by alcohol. A recent study showed that Vivitrex can help people cut way down on alcohol bingeing. That's not the same as abstinence, but Dr. James C. Garbutt, an alcoholism researcher at the University of North Carolina at Chapel Hill, says reduced drinking is still meaningful in a disease that is remarkably resistant to treatment. "If you significantly reduce the number of heavy drinking days, you've made a big impact." Treatment specialists believe that Campral and Vivitrex may be most effective when used in combination.

INDIFFERENCE AT LAST

EXISTING DRUGS APPROVED for other purposes may end up being part of that combination. The field got a jolt last August from a study in *The Lancet* that showed that Topamax, an anti-seizure medicine from Johnson & Johnson, helped 13 of 55 patients abstain from drinking for a month. Dr. Bankole A. Johnson of the University of Texas Health Science Center at San Antonio, who headed the study, said the patients all started on the drug while still drinking, a significant breakthrough. Campral and Vivitrex are taken after the patient quits.

Still, no drug is recommended in a vacuum. "We are developing better and better medications, but they need to be taken in a therapeutic context," says Kleber—which may include AA and other types of behavioral therapies. Dr. Ameisen, for one, found it much easier to use the techniques he learned at AA while on baclofen. But it was the drug that changed his life. "At the end of my ninth month of complete liberation from symptoms of alcohol dependence, I remain indifferent to alcohol," he writes. "Abstinence has become natural to me." ■

—By Catherine Arnst in New York

Foods With a Health Boost

More companies are adding natural nutrients in higher-than-natural concentrations. Here's what you need to know before you buy. **BY JANE BLACK**



I T LOOKS LIKE REGULAR yogurt. It tastes like regular yogurt. But Yoplait Healthy Heart, according to its maker, is super-yogurt. Released in March, Yoplait Healthy Heart is the first yogurt in the U.S. to serve up plant sterols—naturally occurring substances that scientific research shows may inhibit the absorption of cholesterol. Two six-ounce servings of Yoplait Healthy Heart provide 0.8 grams of plant sterols—the equivalent of 22 servings of brussels sprouts, 26 oranges, 44 apples, or 70 large carrots. We're in the midst of an all-out "phood" fight as dozens of foods and beverages fortified with pharmaceutical-grade ingredients hit the market. Besides Yoplait's latest,

other recent launches include Dannon's DanActive, a drink that contains 10 times the culture found in traditional yogurt and aims to "strengthen your body's natural defenses"; Logic Juice 4 Joints, a fruit drink with glucosamine and chondroitin that may ease arthritis and joint pain; and Omega eggs, from chickens fed a diet high in omega-3 fatty acids, which are believed to reduce the risk of heart disease. These are such established functional foods, or nutraceuticals, as Benecol spreads, which do contain plant sterols; Kellogg's Smart Start cereals, enriched with antioxidants or soy protein; and Wonder Bread with added folic acid.

There's more under development. On Mar. 15 scientists at the Agriculture Dept. reported that the cellulose derivative HPMC helped prevent hamsters on a high-fat diet from absorbing fat and developing insulin resistance, a precursor to type 2 diabetes. Should human studies confirm the findings, the tasteless, colorless compound could enhance hamburgers, hot dogs, and fried chicken within two years. "Obviously, the less fat you eat, the better off you are," USDA researcher Wallace H. Yokoyama told the Mar. 15 meeting of the American Chemical Society. "But if you're going to eat high-fat foods, adding HPMC to them might limit the damage."

The growing food-with-a-boost phenomenon stems from both the easing of food-labeling laws and the industry's desire to appeal to health-conscious baby boomers. According to a 2004 study by the Food

Marketing Institute, 56% of Americans strongly agree that eating well is a better way to prevent health problems than taking drugs.

The proof is at the checkout line: Sales of packaged bread with a nutraceutical component rose 16%, vs. a 0.6% decline for bread overall, says market research firm Packaged Facts. Sales of yogurt and yogurt drinks with additives rocketed 22%, compared with 6% for all yogurts. Overall, functional-food sales totaled \$7.3 billion in 2004, up 5% from 2003, compared with a 2.6% growth rate of supermarket sales. Although you pay a premium for some newcomers, such as Yoplait Healthy Heart, most cost the same as their regular counterparts, says Packaged Facts.

Clearly, the industry likes functional foods. But should consumers seek them out? Nutritionists argue that many of them don't contain enough benefits to make up for their nutritional drawbacks, such as high sugar or fat content.

Plus, they say, it's always better to get nutrients naturally: If you want omega-3 fatty acids in your diet, eat oily fish, such as wild salmon—not multigrain pizza fortified with them, which Canada's Pizza Pizza chain introduced on Feb. 15. "Often you get one healthy ingredient in a not-so-healthy food," says Dr. Andrew Weil, founder of the University of Arizona's Program in Integrative Medicine. "That concerns me as a physician."

Still, if you can't stand salmon or want a concentrated dose of plant sterols without eating 70 carrots, some of these foods may be worthwhile. Before you buy, start by reading the label. The Food & Drug

Administration sanctions two kinds of health claims: unqualified, in which the stated benefit relating to a specific disease is backed by scientific research, and qualified, where the FDA evaluation of the evidence is not conclusive. Vague claims—which make no mention of a disease but offer generalizations such as "improves heart health" or "builds strong bones"—have no FDA stamp of approval.

Few of these foods can make any claims yet. But products with plant sterols can offer unqualified claims to reduce cholesterol. Omega-3-enhanced foods can display a qualified statement about heart disease, and antioxidant-enriched foods can make qualified claims of reducing cancer risk. Breads fortified with folic acid can make a qualified claim to lessening the chances of neural-tube defects in babies—but not to lowering the risk of heart disease and stroke, as studies have suggested.

HOW MUCH DO YOU NEED?

IF YOU'RE SATISFIED with the health claim, check the amount of additive per serving. Often one serving contains far less than is required to improve health. With DanActive, just one 3.3-oz. bottle is recommended each day, but you must eat two servings of Yoplait's Healthy Heart yogurt each day get 0.8 grams of plant sterols. Over four weeks, you'll receive the advertised benefit of a 6% reduction in "bad" LDL cholesterol, as calculated in a 1999 plant-sterol study in *European Journal of Clinical Nutrition*. For a therapeutic dose of glucosamine, studies show you need a minimum of 1,000 mg. each day. A 12-oz. can of Juice 4 Joints contains 1,250 grams, while

Glacéau's popular Vitamin Water "Balance" cran-grapefruit flavor contains just 250 grams in a 20-oz. bottle.

Be sure you're not getting a heavy dose of fat or sugar that counteracts the benefit. Dark chocolate has antioxidants, says Madelyn H. Fernstrom, director of the University of Pittsburgh Medical Center Weight Management Center, but eating it to cut cancer risk is no excuse for a high-calorie snack. A better option is green tea.

Of course, if you're going to eat a piece of chocolate anyway, you're better off with dark. And if you love yogurt and have a family history of heart disease, an extra helping of plant sterols can't hurt. ■

Just be sure the sugar or fat content doesn't outweigh the benefits

a mountain of copy paper: \$98

(knowing it gets you that much closer to a mountain bike: priceless)



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FIRST QUARTER REPORT

Follow the Raging Oil Bulls

Energy funds may head higher. But most stock and bond funds look earthbound. **BY SUZANNE WOOLLEY**

THE WINNING STRATEGY for fund investors this year can be summed up with a simple image: a big, black gusher of oil. Oil prices that raced from \$40 a barrel to more than \$55 carried funds focused on natural resources to an average total return of 10.9% for the first quarter, more than five times the gain of any other fund category. With strong global demand and most suppliers pumping it out, the outperformance should continue as the year goes on.

Naturally, higher energy prices are weighing on the broad stock market. And so is the specter of higher inflation—and higher interest rates. The Federal Reserve recently hinted that there may be a longer cycle of rate hikes than many market participants had expected. That signal also moves any remaining allure of bonds as a refuge: For the past several years exposure to bonds helped offset down days in

the stock market. But lately bonds haven't provided much ballast: While investors in U.S. diversified equity funds saw not a dribble of a return as their funds fell an average 3%, the average bond fund also showed a loss, down 0.9%. (Fund data are for the first quarter through Mar. 28. They're calculated by Standard & Poor's, which, like *BusinessWeek*, is a part of The McGraw-Hill Companies.)

Can the strength in natural resources last? Absolutely, insists raging oil bull Kenneth Heebner, who had three of his four Capital Growth Management funds among the quarter's top 100 funds. Energy investments helped drive the \$1.1 billion CGM Focus fund up 10.1%. The case for continued gains: "Demand growth in China isn't slowing down," Heebner says, "and there's accelerating demand from India and other parts of Asia." Leigh Goehring, whose \$655 million Jennison Natural Resources fund rose 9.8%, is also gung ho on energy. His 65% weighting in oil is the highest it has been in his 13 years at the fund.

While Heebner's top holdings include large caps such as Amerada Hess, Goehring focuses on companies with projects in the Canadian oil sands. There, the high-cost process of extracting bitumen out of oil sands has become more economical as oil prices have risen. His favorite pick in the sector is Opti Canada. (His fund was a backer of the company when it was private.) He also likes Canada's Suncor Energy. "Companies with access

to long-lived, robust reserves will be the winners," says Goehring. "For practical purposes there are unlimited reserves in the oil sands, and these companies are still cheap."

What's also cheap—and getting cheaper every day—are growth stocks and the funds that invest in them. Large-cap growth funds lost 4.3% since January, and small-caps dropped 5.1%, dragged down, in part, by their tottering technology holdings. Tech is one area where aggressive investors should venture, says James Paulsen, chief investment strategist for Wells Capital Management. "When investor sentiment improves, tech will be one of the first sectors to benefit."

As the U.S. stock market struggled, returns were better, but hardly stellar, abroad. Diversified emerging markets



Big Equity Funds In the Doldrums

FUND	ASSETS (BILLIONS)	FIRST QUARTER TOTAL RETURN*
Vanguard 500 Index Inv.	\$83.5	-2.72%
Investment Company of America A	65.1	-1.45
Washington Mutual Investors A	63.2	-2.28
Growth Fund of America A	60.8	-2.37
Fidelity Magellan	59.7	-3.05
Standard & Poor's Depository Rcpts.	49.5	-3.10
Fidelity Contrafund	46.7	-0.30
Dodge & Cox Stock	44.9	-1.03
Income Fund of America A	43.8	-2.75
EuroPacific Growth A	38.2	-0.17

*Appreciation plus reinvestment of dividends and capital gains before taxes Jan. 1-Mar. 28, 2005

Data: Standard & Poor's

Personal Business Mutual Funds

funds were up 0.8% and those specializing in Asia (ex-Japan) gained the most, up 1.7%. And more U.S. investors are seeking opportunities overseas. According to research firm Strategic Insight, international equity funds captured \$40 billion of assets in the first quarter, almost half of the net inflows into all equity funds.

SURPRISING OPPORTUNITIES

SOME GLOBAL FUNDS are finding success in unusual places. The \$321 million T. Rowe Price Emerging Europe & Mediterranean Fund credits much of its 9% gain to its stake in Egypt. There, a new cabinet is instituting structural economic reforms, such as slashing personal income-tax rates. "By emerging market standards, top-tier Egyptian corporations are good quality," says Todd Henry, an emerging-markets portfolio specialist at T. Rowe Price. "We think reform momentum will continue."

Investors waiting for the U.S. stock market to sort itself out won't find many opportunities in bond funds. The high-yield municipal category gained 0.8%, but aside from a 0.04% return for ultrashort bonds, all other categories of bond funds were down. With interest rates heading higher, the challenge to bond investors is pretty cut-and-dried, says Kenneth Buntrock, manager of the \$1.1 billion Loomis Sayles Global Bond Fund: "What do you do in a bond bear market?"

One option is to seek better returns

Rising Rates Weigh On **Bond Funds**

FUND CATEGORY	FIRST QUARTER TOTAL RETURN*	FUND CATEGORY	FIRST QUARTER TOTAL RETURN*
Muni. High Yield	0.81%	Muni. National Intermediate	-0.90%
Ultrashort	0.04	Long (General)	-0.97
Muni. Calif. Long	-0.15	High Yield	-1.06
Muni. Single-State Long	-0.30	Intermediate Government	-1.16
Muni. New York Long	-0.34	Intermediate (General)	-1.25
Muni. Short	-0.34	Multisector	-1.58
Long Government	-0.48	International Bond	-2.38
Muni. National Long	-0.48	Emerging Markets Bond	-2.49
Short (General)	-0.62	Convertibles	-3.83
Muni. New York Intermediate	-0.69		
Short Government	-0.74	Tax-Free Bond Funds	-0.49
Muni. Single-State Intermediate	-0.79	All Bond Funds	-0.87
Muni. Calif. Intermediate	-0.90	Taxable Bond Funds	-1.19

*Appreciation plus reinvestment of dividends and capital gains before taxes, Jan. 1-Mar. 28, 2005

Data: Standard & Poor's

outside the U.S. But one of the most popular global bond fund categories—emerging markets—is in a pullback. After a 6.3% gain in 2004's fourth quarter, down from 9.2% the previous quarter, emerging-markets bond funds fell 2.5% in the first three months of 2005.

Another approach is to buy funds that invest in foreign currency bonds, looking to benefit from a falling dollar—but you can't count on that. In fact, in the wake of the Fed's recent rate hikes, the dollar has

strengthened against the euro and the yen.

That sends bond investors back home. One approach to rising rates is to "shorten up"—buy bonds or bond funds with short maturities. Those bonds will mature in a couple of years. The yields are lower than intermediate and long-term bonds, but the value is less affected by higher rates. The shortest-maturity funds, of course, are money market funds. The average maturity of the securities in money funds is less than 90 days. Right now the average taxable money fund yields about 2%. The advantage is that you're not locked in still-low yields, and money-fund returns will rise as the Fed lifts rates.

A less traditional short-term play is bank-loan fund (also called a prime-rate fund). Such funds invest in floating-rate bank loans—and the yields adjust along with short-term rates. Because the credit ratings on the loans are below investment grade, the yields are typically higher—more than two percentage points above the London interbank offered rate (LIBOR), which is now 3.1%. The rub: Some funds have expenses as high as 1.5%. An example is the Morningstar, Fidelity Floating Rate High Income Fund is the only no-load offering.

In coming months the investing climate will be challenging as the market is buffeted by economic crosswinds. Stuffing money under the mattress starts to seem like a wise move, remember that the smartest strategy is often contrarian. "For the last two years people have said that the stock market was going to die," says Wells's Paulsen. "As long as people keep saying it's over, it ain't." ■

Red Ink For Most **Equity Funds**

FUND CATEGORY	FIRST QUARTER TOTAL RETURN*	FUND CATEGORY	FIRST QUARTER TOTAL RETURN*
Natural Resources	10.94%	Large-cap Blend	-2.62
Utilities	1.90	All Cap	-2.93
Pacific/Asia ex-Japan	1.69	Small-cap Blend	-3.07
Diversified Emerging Markets	0.81	Mid-cap Growth	-3.34
Diversified Pacific/Asia	0.76	Large-cap Growth	-4.30
Europe	0.14	Small-cap Growth	-5.07
Latin America	-0.07	Precious Metals	-5.29
Foreign	-0.14	Health	-5.44
Miscellaneous	-0.28	Financial	-6.24
Mid-cap Value	-0.92	Communications	-7.31
Japan	-1.03	Real Estate	-7.46
International Hybrid	-1.34	Technology	-9.47
Large-cap Value	-1.48		
Mid-cap Blend	-1.51	International Equity Funds	-0.21
World	-1.52	All Equity Funds	-2.56
Domestic Hybrid	-1.90	S&P 500	-2.81
Small-cap Value	-2.40	U.S. Diversified Funds	-2.98

*Appreciation plus reinvestment of dividends and capital gains before taxes, Jan. 1-Mar. 28, 2005

Data: Standard & Poor's

Take Me Out to The Museum

So hot dogs at these outings, but baseball's history comes alive. **BY MARK HYMAN**

A TICKET TO OPENING day for your favorite team is a prize some fans wouldn't trade for 20 Roger Clemens autographed baseballs. Still, it isn't the only way for a baseball diehard to celebrate the start of the season. If you can't secure a seat at the game, you can always visit a museum.

Baseball museums can't compete with the ballpark for the excitement of a squeeze bunt or the taste of a hot dog gathered with sauerkraut. But what they lack in ambiance they make up in their evocation of the rich history of the game. Baseball is a natural subject for museum treatment given its inextricable links to American culture, says Jeffrey Idelson, vice-president of the National Baseball Hall

of Fame in Cooperstown, N.Y.

When it opens on May 14, Baltimore's Sports Legends at Camden Yards—housed in a 19th-century former train depot adjacent to the ballpark—will become the newest shrine (www.sportslegendsatcamdenyards.com). Although it celebrates many sports, its baseball exhibits are especially impressive. They include tributes to icons Babe Ruth and Cal Ripken, both Maryland natives. The Ruth collection features a Louisville Slugger bat from 1927, when Ruth hit 60 home runs, and a scorecard from his first big-league game in 1914. In the Ripken section are the four banners with numerals 2131 that hung from the Camden Yards warehouse when he broke Lou Gehrig's consecutive-game record in 1995.

About a dozen baseball-themed museums beckon visitors to big-league cities and out-of-the-way burgs. The roster is divided into two categories: halls celebrating the lives of legendary players and those telling the story of cherished institutions or an essential piece of gear.

Legends with museums to call their own include Hall of Fame pitcher Bob Feller (Van Meter, Iowa), home-run slugger Roger Maris (Far-

go, N.D.), Yankees catcher and malaprop artist Yogi Berra (Montclair, N.J.), and hitting icons Ted Williams (Hernando, Fla.), Ty Cobb (Royston, Ga.), and Babe Ruth (in the Baltimore rowhouse where he was born). Coming on Apr. 30: a museum honoring Honus Wagner, a stellar Pittsburgh Pirates infielder and hitter of the early 1900s, in the Flying Dutchman's hometown of Carnegie, Pa.

NOTES FOR YOGI

THE BERRA MUSEUM is on the Montclair State University campus, and of its 40,000 visitors each year, half are kids in school groups (yogiberramuseum.org). "We have a little box where kids can drop notes to Yogi. More than once we've taken out a note that said: 'Are you dead yet?'" says Executive Director Beth Sztuk.

Feller's shrine is situated near his boyhood home (bobfellermuseum.org). "Being immortalized while you're still alive, it is interesting," notes Feller, 86, baseball's dominant pitcher in the 1940s. Similarly, former Yankees slugger Roger Maris, who died in 1985, lived long enough to see the first visitors stream into a museum in his honor in

BALTIMORE
Babe Ruth greets visitors to the sports legends museum



LOUISVILLE AND FARGO, N.D.
Free mini bats—and entry to the Maris museum is free, too



(BOTTOM, L-R) THE LOUISVILLE SLUGGER MUSEUM; BILL KLOUBEC

Fargo (rogermarismuseum.com). The displays are set up in a corridor of a shopping mall, and visitors can mill around without paying an admission charge. "He decided it would be nice to display things people wanted to see, but he didn't want anyone to have to pay to see them," says Pat Maris, Roger's widow.

The Negro Leagues Baseball Museum in Kansas City, Mo., is one of the institutions focused on an aspect of baseball's history (nlbm.com). In its 75-seat theater, with bleachers, you can view films that tell of the hardships endured by black stars barred from playing on the same diamonds as their white counterparts. The museum also boasts a "Field of Legends" exhibit featuring life-size bronze sculptures of 10 Negro Leaguers inducted into the Baseball Hall of Fame. In Kentucky, Louisville Slugger, which has been turning out wooden bats for big-leaguers since 1905, offers tours of its factory. After watching wood chips fly, visitors get a complimentary mini bat, and, for \$48 to \$65, they can take home the real item emblazoned with their printed names or signatures (sluggermuseum.org).

The Little League Museum in Williamsport, Pa., sits on a hilltop a mere pop up from Howard J. Lamade Stadium, the field that hosts the Little League World Series each August (litleague.org/museum). It traces Little League to its roots in 1939 and offers lots of photos and displays of uniforms and caps worn by tyke players over the years. Surprisingly, given its subject, the museum's sober, straightforward telling of the youth league story seems targeted at adults as much as kids.

The National Baseball Hall of Fame remains the gold standard. It houses an unmatched collection of historic items, including the ball Maris socked into the stands for home run No. 61 in 1961, then a big-league record (baseballhalloffame.org). It just completed a \$20 million renovation that added 10,000 square feet of space. Among the new exhibits: "Taking the Field: The 19th Century," an in-depth exploration of baseball's beginnings. Cooperstown's Hall of Fame still ranks as the most-visited baseball museum, drawing nearly 350,000 visitors each year. Not a bad turnout for a look at some scuffed balls and worn-out mitts. ■

BusinessWeek online For a slideshow on baseball museums, go to businessweek.com/extras

Broker or Adviser?

Be forewarned: If yours is employed by a brokerage your interests come second. **BY TODDI GUTNER**

NOWADAYS STOCK-brokers bill themselves as financial consultants, financial advisers, or even investment advisers. Are they any different than investment advisers who don't work for brokerage firms?

You bet. Broker "advisers" and independent advisers, though both may charge a percentage of your assets for their services, operate under different regulatory regimes. Independent advisers must act as fiduciaries, which means they must put their clients' best interests ahead of their own. So an adviser recommending a Standard & Poor's 500-stock index fund must put your money in a no-load fund with the lowest annual expenses. A broker might recommend an S&P 500 fund, too, but can choose a load fund with higher expenses. A broker has an obligation to serve the client, but the broker's first duty is to the firm.

Organizations such as the Financial Planning Assn. and the Consumer Federation of America want broker-advisers to meet the same fiduciary standards as independent advisers. But this month the Securities & Exchange Commission will likely make a permanent rule that exempts fee-based brokers from advisers' fiduciary obligations. Industry insiders say the SEC figures brokerage oversight and the arbitration system, which is currently handling a record number of complaints against brokers, offer sufficient protection to clients.

Regardless of how the SEC rules, investors should quiz their brokers and advisers to better understand their obligations, compensation, and conflicts.

Do you provide fee-based advice as a registered investment adviser (RIA) or under the broker exemption allowed by the SEC?

If the answer is RIA, then this is the only



question you'll need to ask. The law requires RIAs to disclose the information below. If the answer is broker exemption, ask two more questions.

Do you receive incentives or third-party payments for selling certain investments?

Besides the fees disclosed in mutual fund prospectuses and the commission received from trading, brokers can earn other compensation or qualify for prizes or vacations if they meet specific sales quotas.

Are you encouraged to sell stocks that the firm has in its inventory?

The brokerage firm can sell you a stock from inventory—at the best price available anywhere. But commissions for those stocks are higher than for stocks not from inventory. So the broker will often earn more for selling the stock of a company with which the firm has done an initial public or secondary offering.

Sure, the SEC has a mandate to protect investors. But in an imperfect world, investors also have an obligation to protect themselves. ■



Phil Davidson
Chief Investment Officer
U.S. Value Equity



Chuck Ritter
Vice President
Senior Portfolio Manager



Meet Phil and Chuck. Please pardon their enthusiasm.
They've just beaten the S&P 500. Again.

Name of Fund	1 Yr.	5 Yrs.	10 Yrs.	Life of Fund	Inception Date
Value* (TWVLX)	14.36%	11.46%	14.05%	12.99%	9/1/93
Large Company Value* (ALVIX)	14.28%	8.49%	—	6.59%	7/30/99
Equity Income (TWEIX)	12.53%	12.51%	15.34%	14.74%	8/1/94
S&P 500	10.88%	-2.30%	12.07%	—	—

Average annual total returns as of 12/31/04

Data presented reflect past performance. Past performance is no guarantee of future results. Current performance may be higher or lower than the performance shown. Investment return and principal value will fluctuate, and redemption value may be more or less than original cost. To obtain performance data current to the most recent month end, please call 1-877-442-6236 or visit americancentury.com. Performance reflects Investor Class shares. For information about other share classes available, please consult the prospectus. Data assume reinvestment of dividends and capital gains.

The S&P 500 Index is a capitalization-weighted index of 500 widely traded stocks. Created by Standard & Poor's, it is considered to represent the performance of the stock market in general. It is not an investment product available for purchase.

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You should consider a fund's investment objectives, risks, and charges and expenses carefully before you invest. The fund's prospectus, which can be obtained by calling 1-877-442-6236, contains this and other information about the fund, and should be read carefully before investing.

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EDITED BY TODDI GUTNER

PHOTOGRAPHY

MAKE THAT DISH LOOK REALLY YUMMY

FOOD PHOTOGRAPHY is tricky. Just ask people who have tried to get a shot of a Thanksgiving turkey with trimmings, or wanted to capture a moment at an elegant restaurant. All they're likely to get are half-baked snapshots where the food looks pasty and washed-out.

Now most new cameras from **Pentax** and **Olympus** can take the guesswork out of your epicurean close-ups. Along with presets that ready the camera for specific situations, such as fireworks, sports, or portraits at night, there's a "food" or "cuisine" mode that makes the colors more vibrant and appealing.

For this appetizer of togarashi tuna from the Hillview Grill in Sarasota, Fla., the Olympus Stylus 500 softened the



flash, intensified the contrast, and warmed up the colors (left) compared with the camera's normal setting (right). Tip: If you're taking pictures in a fancy restaurant, it's a good idea to ask your waiter first. Some chefs are sensitive about their creations.

With food mode, you'll get better results if you use the flash and, for food that's served low on the plate, shoot from the top down. For a fanciful dessert that soars over the plate, find an angle that keeps the whole tower in focus and highlights its three-dimensional aspects. If it's a birthday cake you're shooting, you'll get a better picture if you switch to the camera's "candle" mode.

—Larry Armstrong



STOCKS

The Congress Effect

IT'S AN OLD WALL STREET axiom that legislators are bad for stocks. Now, two finance professors have discovered strong evidence that Congress does depress market returns. Michael Ferguson of the **University of Cincinnati** and Douglas Witte of the **University of Missouri** looked at stocks over the past 104 years, comparing daily returns when Congress was in session with when it was in recess.

Even after removing other seasonal trends, such as the January effect (stocks tend to rise in January), the study found returns were 2 to 6 percentage points higher, in annual terms, during periods when Congress was out of town. The less popular Congress is based on 40 years of monthly Gallup and Harris polls, the more pronounced the effect. Fully 90% of gains in the Dow Jones industrial average occurred during recesses. (Half of those gains can be attributed to other previously uncovered seasonal effects.)

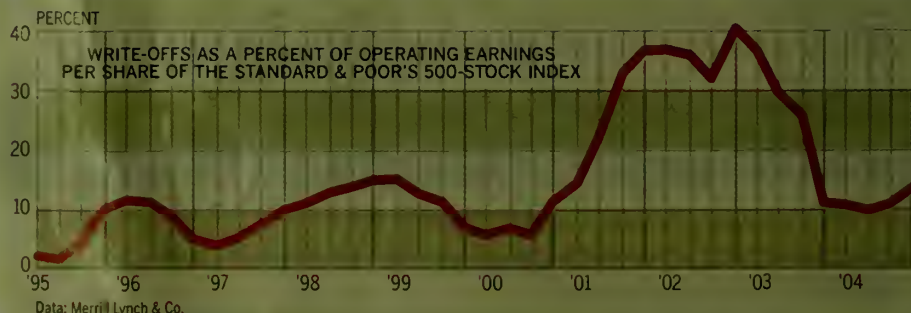
Though the study is compelling, Witte warns it would be tough to design a trading strategy around just the legislative calendar. But if you have a big chunk to invest, he says, "do it right before Congress is going to take a break."

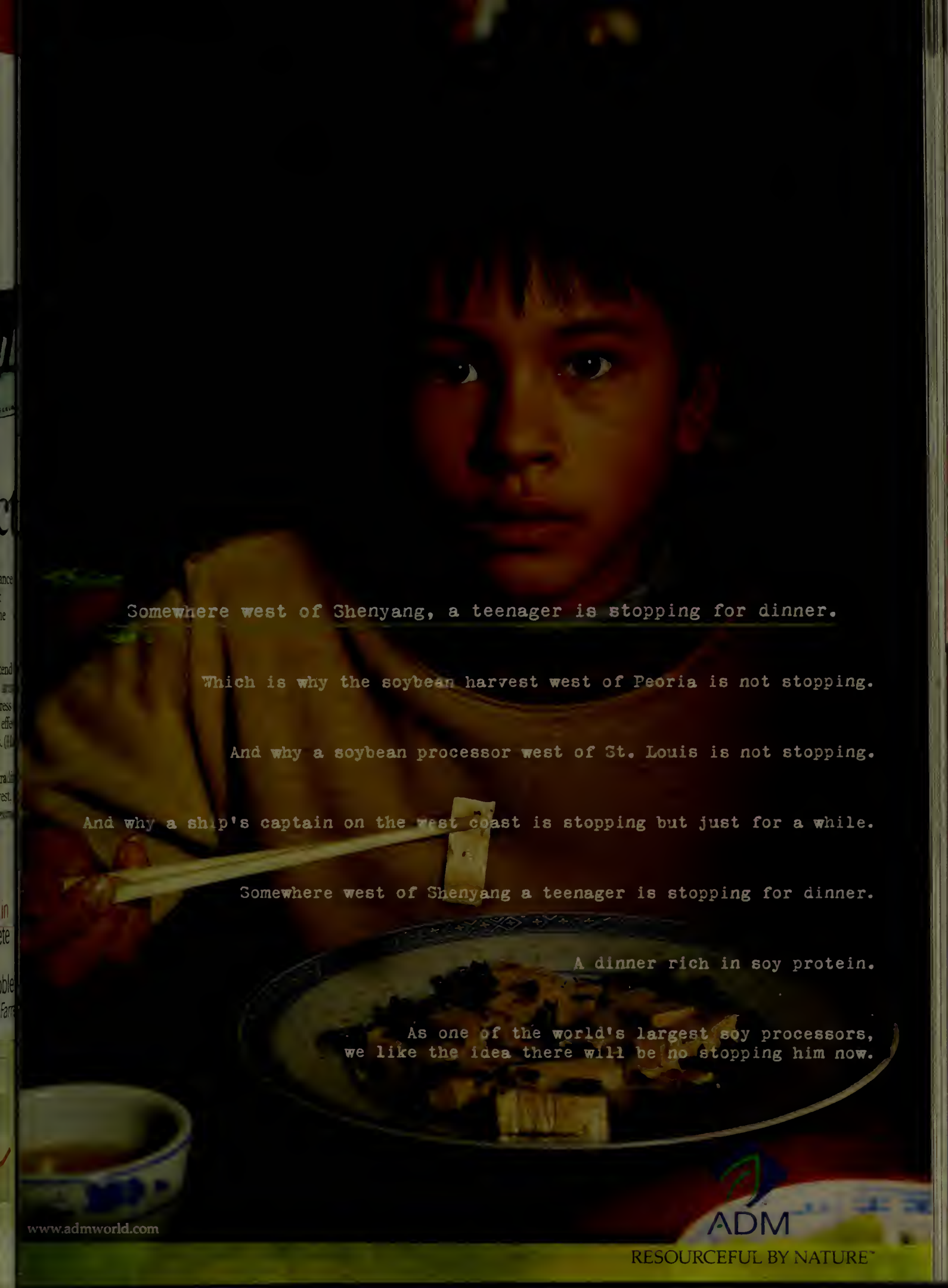
—Aaron Pressman

WRITE-OFFS

WHEN FIRST-QUARTER profits come in, expect an increase in write-offs for bad acquisitions, shuttered plants, and obsolete inventories. These charges, measured as a percentage of operating earnings per share, are down from their post-bubble peak, but they're starting to climb again.

—Christopher Farrell



A young person with bangs is shown from the chest up, holding chopsticks and eating. The background is dark and out of focus. The text is overlaid on the image in a typewriter font.

Somewhere west of Shenyang, a teenager is stopping for dinner.

Which is why the soybean harvest west of Peoria is not stopping.

And why a soybean processor west of St. Louis is not stopping.

And why a ship's captain on the west coast is stopping but just for a while.

Somewhere west of Shenyang a teenager is stopping for dinner.

A dinner rich in soy protein.

As one of the world's largest soy processors,
we like the idea there will be no stopping him now.



BY ROBERT BARKER

What's Looming Over Boise Cascade

Suppose you control a big forest-products company. Business is pretty good, but higher energy costs threaten margins. Worse, an accounting scandal has led to

the departure of your top customer's CEO. And now a big investor in that No. 1 customer is agitating to get it auctioned or busted up. You might want to trim your interest in the forest-products company, right?

So it's easy to see why Boise Cascade is preparing to sell stock in an initial public offering. Controlled by the large, Chicago-based private-equity firm Madison Dearborn Partners, Boise Cascade finds itself linked to OfficeMax and its ongoing travails. Behind Staples and Office Depot, OfficeMax is a weak No. 3 in office supplies. In March, even as it looked for a new chief executive, OfficeMax had to restate 2004 financial results. Boise Cascade has not yet said how much equity it aims to float or at what price. But its Securities & Exchange Commission filing spells out the company's many ties to OfficeMax—a tangled relationship that should give investors pause before bidding on this IPO.

FOUNDED IN 1988, OfficeMax grew swiftly but by 2003 was persistently lagging behind its two bigger rivals. That December it wound up being bought by Boise Cascade, then a

venerable public company known best for its interests in paper and wood products. But since 1964 it also had been in the wholesale stationery biz via its Boise Office Solutions unit—hence OfficeMax's allure. After merging the stationery operations, last fall the unit adopted OfficeMax as its corporate name and sold control of the paper and wood-products businesses to a group led by Madison Dearborn. Those

businesses kept the Boise Cascade name.

Now take a breath—the tale gets even more twisted. Turns out this was one of those divorces where the parties insist on remaining friends. OfficeMax kept a minority stake in Boise Cascade and also agreed to buy all of the cut-to-size paper it needs in North America from Boise Cascade through 2012. For the nine months ended on Sept. 30, those sales came to \$434 million—about 10% of Boise Cascade's total revenue. In addition, before the divorce, OfficeMax agreed to take over Boise Cascade's pension and post-retirement benefit obligations to former employees while also funding a big chunk of Boise Cascade's ongoing pension obligations. So Boise Cascade is escaping any 2005 payment to its pension plan. OfficeMax also stayed on the hook for Boise Cascade's past environmental liabilities. With these benefits and more, Boise Cascade is nicely profitable (table).

As for OfficeMax, since the breakup it has gone from trouble to more trouble. In March it reported that the operating margin at its stores had narrowed to 0.5% last year from 2.2% in 2003. It also is being challenged by K Capital Partners, a Boston fund with 6.2% of OfficeMax. It's exploring a breakup or sale to realize what it sees as the company's full intrinsic value. If OfficeMax were to dissolve or change directions, would that force Boise Cascade on the ropes? No. But, as Boise's SEC filing notes: "Any significant deterioration in OfficeMax's financial condition or our relationship with OfficeMax may result in OfficeMax's failure to satisfy its contractual obligations to us and, as a result, could have a material adverse effect on our business, financial condition, and operating results."

OfficeMax looms, then, as a large imponderable over the future of Boise Cascade. Give Boise Cascade's current owners your sympathy—but hold on to your money. ■

E-mail: rb@businessweek.com



MINNESOTA PLAN

Boise's ties to OfficeMax could drag it down

Boise Cascade: Floating Paper

	MILLIONS
Revenue	\$4,399
Operating income	321
Net income	151
Total debt	1,856
Shareholders' Equity	339
Ticker symbol	BCC*

For nine months ended on Sept. 30, 2004
* tentative

Data: Company reports



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CODE: MRABWF

TDW3852



BY GENE G. MARCIAL

METLIFE IS GETTING BIG SMILES FROM WALL STREET ANALYSTS.

RICH VIDEO-ON-DEMAND PATENTS HAVE ACACIA SITTING PRETTY.

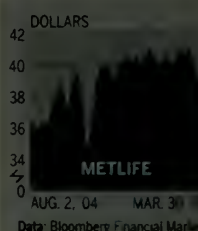
THE KNOT IS HELPING MORE COUPLES PLAN THEIR WEDDINGS.

Thumbs Up for MetLife

JONATHAN FERRELL, FOUNDER and manager of Top Flight Fund, cares little about forecasting a company's business fortunes. Instead, he tracks changes actually going on—such as earnings surprises or analysts' estimate revisions. He buys or sells a stock depending on how his proprietary model predicts what the investors' reactions will be to such changes. Right now his eye is on MetLife (MET), a global provider of individual insurance, annuities, and investment products. It also offers group insurance, plus retirement and savings services, to corporations. Ferrell bought shares in part because in the past few weeks he has seen a lot of upgrades in analysts' estimates. Ferrell figures MetLife is cheap on various measures, such as price to free cash flow, price to sales, and price to book value. "It is a large-cap value play that will jump in the near term," says Ferrell. Lately the shares have traded in a narrow

band—between 38 and 41; they're now at 39. In 2003, Top Flight Fund's first year, the fund gained 52.84% vs. 28.54% for the Standard & Poor's 500-stock index. In 2004 it was up 13% vs. the S&P's 10.8%. This year through Mar. 29, the fund is down 8% vs. an S&P drop of 3.8%. Another MetLife fan is Jimmy Bhullar of JP Morgan Chase, who rates it "overweight." The underlying growth in MetLife's business, he notes, continues higher than projected, resulting in MetLife's profits exceeding his estimates for the fourth consecutive quarter. It trades at 10.8 times his 2005 net forecast of \$3.60 a share—about 5% below its peers' ratio of 11.7. Bhullar thinks such a discount is unwarranted, based on MetLife's long-term potential growth rate of about 12%.

AN ELEVATED PLATEAU



Data: Bloomberg Financial Markets

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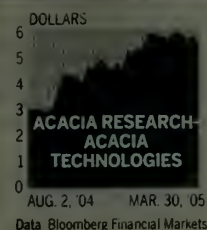
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Tiny Giant in Video Patents

THE POWERHOUSES of cable and satellite TV are starting to feel the presence of tiny Acacia Research-Acacia Technologies (ACTG), which owns 7 patents covering digital media transmission, mainly video on demand. According to CEO Paul Ryan, Acacia has licensed 294 cable-TV and Net outfits—including Bloomberg and Disney—to use Acacia technology. Acacia has filed suits against Comcast, Cox, DirecTV, EchoStar, and Charter on alleged patent infringement. "Experts believe Acacia will prevail," says Paul Haber, an investment adviser at Leeb Group. If so, it sees revenues of about \$100 million a year through 2011, based on recent six-year licensing pacts. The stock, now at 5.55, is worth more, he says. Still in the red, Acacia posted revenues of \$4.3 million in 2004. Ryan sees a jump in revenues from any settlement or court victory alone. DirecTV says it will vigorously fight the suit, as it believes it has no merit. Comcast didn't return calls; the other companies declined comment.

HIGH HOPES OF PROFITS AHEAD

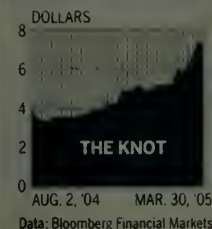


The Knot: Here Come the Brides

WEDDINGS ARE big business, and The Knot (KNOT) is a pure player in that hot market. Weddings account for \$72 billion in annual domestic retail sales, notes CEO David Liu, who says The Knot's revenues

have jumped from \$24.1 million in 2001 to \$41.4 million in 2004. The company turned profitable in 2003, earning \$1 million, or 5¢ a share. In 2004, it made \$1.3 million, or 7¢. Just six years old, the company provides information, products, and services on its Web site and in its magazines to couples planning to get married. Its services include a registry where engaged couples list their gift preferences at specific stores. The Knot has inked a pact this month with Target for the retailer to offer its products on The Knot Web site, which has one million active members. Target is the largest wedding gift registry retailer. Liu says The Knot's services span the period from engagement to motherhood. Justin Cable of securities firm B. Riley says The Knot's online business showed solid growth in 2004 and should expand again this year. Rob Amman, managing partner at R.K. Capital Management, which owns stock, says the shares, now at 7.20, are cheap, in light of The Knot's rapid growth and high-margin (75%) business. He sees it earning 9¢ a share in 2005 on sales of \$50 million. But that will jump to 46¢ next year, he says, on sales of \$60 million, due to a widening in the margins and a jump in vendor ads on its Web site and magazines. ■

MARCHING UP THE AISLE



BusinessWeek online

Gene Marcial's Inside Wall Street is posted at businessweek.com/today.htm at 5 p.m. EST on the magazine's publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor their firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.

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STOCKS



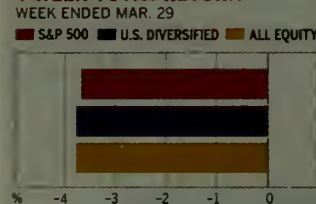
COMMENTARY

A drop in oil prices on Mar. 30 ignited a stock-market rally, sending indexes up for the week. Adding to the good cheer was news that the economy grew at a 3.8% clip in the last quarter of 2004. Investors, though, are fickle: Buyers shaved billions in market cap off of Caterpillar on fears that profits have peaked for the heavy-equipment maker. Meanwhile, scandal-plagued insurer AIG fell on new concerns over its accounting.

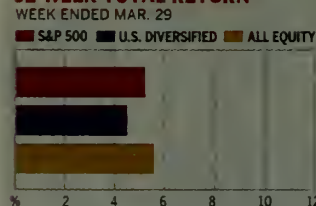
Data: Bloomberg Financial Markets, Reuters

MUTUAL FUNDS

4-WEEK TOTAL RETURN



52-WEEK TOTAL RETURN



Data: Standard & Poor's

U.S. MARKETS

	MAR. 30	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1181.4	0.8	-2.5	4.8
Dow Jones Industrials	10,540.9	0.8	-2.2	1.5
NASDAQ Composite	2005.7	0.8	-7.8	0.3
S&P MidCap 400	656.3	0.3	-1.1	9.2
S&P SmallCap 600	321.4	0.5	-2.3	12.2
DJ Wilshire 5000	11,634.0	0.7	-2.7	5.4

SECTORS

			% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
BusinessWeek 50*	698.5	0.3	-0.9	11.4
BW Info Tech 100**	349.8	0.4	-6.3	0.2
S&P/BARRA Growth	570.9	0.7	-1.9	2.8
S&P/BARRA Value	606.1	0.8	-3.1	6.8
S&P Energy	332.9	-0.5	15.3	42.8
S&P Financials	383.4	0.9	-6.7	-3.4
S&P REIT	132.4	1.0	-8.4	3.8
S&P Transportation	225.6	0.1	-6.6	18.7
S&P Utilities	146.4	1.4	3.4	18.9
GSTI Internet	155.8	2.1	-12.6	6.4
PSE Technology	730.6	0.6	-6.2	2.0

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS

	MAR. 30	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	1380.1	0.0	-1.2	
London (FT-SE 100)	4900.7	-0.2	1.8	
Paris (CAC 40)	4064.6	0.8	6.4	
Frankfurt (DAX)	4347.5	0.7	2.1	
Tokyo (NIKKEI 225)	11,565.9	-1.5	0.7	
Hong Kong (Hang Seng)	13,425.8	-1.3	-5.7	
Toronto (S&P/TSX Composite)	9484.3	-0.7	2.6	
Mexico City (IPC)	12,653.4	-1.6	-2.0	

FUNDAMENTALS

	MAR. 29	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	2.04%	2.03%	1.5%
S&P 500 P/E Ratio (Trailing 12 mos.)	19.4	19.6	22.
S&P 500 P/E Ratio (Next 12 mos.)*	15.7	15.8	17
First Call Earnings Revision*	0.79%	0.50%	1.6

*First Call

TECHNICAL INDICATORS

	MAR. 29	WEEK AGO	YEAR AGO
S&P 500 200-day average	1150.8	1150.1	Posit
Stocks above 200-day average	61.0%	65.0%	Neut
Options: Put/call ratio	0.71	0.89	Posit
Insiders: Vickers NYSE Sell/buy ratio	4.82	4.84	Negat

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Health-Care Facilities	10.2	Fertilizers & Ag. Chems.	76.0
Fertilizers & Ag. Chems.	8.2	Oil & Gas Refining	71.4
Distillers & Vintners	7.2	Oil & Gas Exploration	56.3
Health-Care Services	6.7	Steel	54.9
Railroads	6.0	Managed Health Care	49.5

WORST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Home Entertainment	-16.7	IT Consulting	-5
Auto Parts & Equipment	-13.2	Insurance Brokers	-2
Automobiles	-13.2	Automobiles	-2
Multi-line Insurers	-12.3	Electric Mfg. Svcs.	-2
Constr. & Engineering	-12.2	Auto Parts & Equipment	-2

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Miscellaneous	-2.3	Natural Resources	34.9
Utilities	-2.5	Latin America	28.4
Domestic Hybrid	-2.5	Europe	21.2
International Hybrid	-2.9	Utilities	19.8
LAGGARDS		LAGGARDS	
Latin America	-10.2	Precious Metals	-10.1
Diversified Emerg. Mkts.	-8.2	Technology	-9.0
Precious Metals	-5.9	Japan	-3.3
Technology	-5.6	Health	-1.3

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Potomac Sm. Cap/Sh. Inv.	12.3	ProFunds Oil & Gas Inv.	65.1
ProFds. USh. Sm. Cap Inv.	11.4	BlackRock Gl. Res. Inv. A	50.5
Rydex Dyn. Vent. 100 H	9.0	iShares MSCI Austria Idx.	47.2
ProFunds UltSh. OTC Inv	9.0	AIM European. Sm. Co. A	45.8
LAGGARDS		LAGGARDS	
American Heritage Growth	-14.3	Ameritor Investment	-50.0
Wells Fgo. Mgmt. E. Mkts. A	-12.8	Apex Mid Cap Growth	-36.8
U.S. Gbl. Accde. E. Erpn.	-12.1	Reynolds	-31.8
ProFunds Semicdr. Inv.	-11.9	ProFunds Semicdr. Inv.	-31.3

INTEREST RATES

KEY RATES

	MAR. 30	WEEK AGO	YEAR AGO
Money Market Funds	2.26%	2.21	0.2
90-Day Treasury Bills	2.82	2.81	0.95
2-Year Treasury Notes	3.83	3.82	1.58
10-Year Treasury Notes	4.55	4.59	3.84
30-Year Treasury Bonds	4.80	4.85	4.78
30-Year Fixed Mortgage †	6.00	6.05	5.49

†Barr's Quote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
General Obligations	3.91%	4.34
Taxable Equivalent	5.59	6.54
Insured Revenue Bonds	4.0	4.70
Taxable Equivalent	5.73	6.71

THE WEEK AHEAD

NONMANUFACTURERS' INDEX

Tuesday, Apr. 5, 10 a.m. EDT

»The Institute for Supply Management's March non-manufacturing activity index is forecast to have edged down to 59%. That's according to the median forecast of economists surveyed by Action Economics. In February the index posted a small rebound to 59.8%. A reading above 50% indicates an increase in activity. Among nonmanufacturers,

consisting mostly of service industries, new orders accelerated during February, which helped fuel a pickup in hiring.

INITIAL UNEMPLOYMENT CLAIMS

Thursday, Apr. 7, 8:30 a.m. EDT

»New filings for state unemployment benefits most likely stood at 322,000 in the week ended Apr. 2, compared with 324,000 in the period ended Mar. 19. The recent jobless claims figures have moved a little

higher but still indicate a healthy labor market.

INSTALLMENT CREDIT Thursday, Apr. 7, 3 p.m. EDT

»During February, consumers are expected to have piled up an additional \$4.3 billion in debt. In January, installment credit jumped \$11.5 billion. The recent volatility in consumer credit has come from nonrevolving debt, which includes auto loans. Vehicle sales were nearly unchanged in February.

The BusinessWeek production index improved to 239 for the week ended Mar. 19, an 11.4% increase from year ago. Before calculation of the four-week moving average, the index rose to 239.5.

BusinessWeek online

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/magazine/extra.h

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BusinessWeek (ISSN 0007-7135) Issue number 3928, published weekly, except for one week in January and one in August, by The McGraw-Hill Companies, Inc. Executive, Editorial, Circulation, and Advertising Offices: 1221 Avenue of the Americas, New York, N.Y. 10020. Periodicals postage paid at New York, N.Y., and at additional mailing offices. Canada Post Publication Mail Agreement Number 4001250. Return undeliverable Canadian addresses to: DPGM Ltd. 4960-2 Walker Road, Windsor, ON N9A 6J1. Email: bwcustomerservice@mcgraw-hill.com. Postmaster: Send address changes to BusinessWeek, P.O. Box 53235, Boulder, CO 80322-3235.

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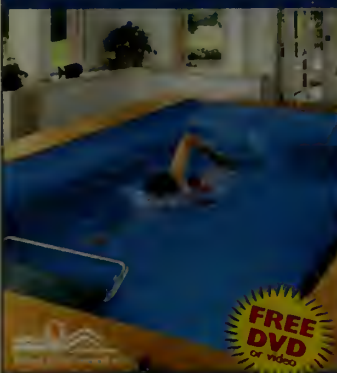
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Hank Greenberg And History

THE FALL OF AMERICAN International Group Inc.'s Hank Greenberg is more tragedy than gratifying comeuppance. However many lines he may have crossed in an era of swiftly changing rules, Greenberg built something real over the course of his long career. Unlike the flim-flam executives of Enron and WorldCom who spun fake empires out of financial gossamer, Greenberg leaves behind a considerable legacy. He played a major role in opening China to foreign investment long before globalization became a buzzword, and his personal relationships with Beijing's mighty profited all investors. His contributions to the Council on Foreign Relations, the Foreign Policy Assn., and other organizations furthering the cause of globalization are substantial.

It's too soon to say what the probes by New York State Attorney General Eliot Spitzer and others will reveal. AIG has admitted giving intentionally false information to regulators during an inspection of its property-casualty business. This may have improperly boosted AIG's reserves, revenues, and stock price. More revelations could follow.

Yet legacies take time to develop. Michael Milken, who was prosecuted by then-U.S. Attorney Rudolph Giuliani, served 22 months in prison for securities violations relating to insider

trading. Yet the man who invented the junk bond market now is remembered as much for the companies that were financed by these instruments—and his support for medical research—as for his transgressions. As a result, Milken's legacy is a favorable one in much of the business community.

The perception of President Richard M. Nixon has also been subject to revision. For many years, Nixon's name was associated with Vietnam, the Watergate break-in, and impeachment hearings. But already his legacy has come to include foreign policy and the opening up of China to the U.S.

The AIG scandal won't dim his legacy in furthering global trade

AIG may turn out to be as odious a corporate scandal as any, and Greenberg's reputation may suffer great damage.

Shareholders have already lost billions. Greenberg ran AIG for

decades, and what may once have been widely acceptable practices no longer are. Much the same thing happened in the investment banking world, where conflicts of interest between analysts were known and condoned in the boom years—until the bust made them unacceptable. The legal and moral lines are shifting in the business world. Greenberg may rightly pay the price of being too arrogant to recognize the changes. Perhaps he remained in office too long, as some CEOs do, filling AIG's board with directors who didn't challenge him for years.

It's important to take stock of Greenberg's accomplishments however. Even executives brought down by scandal are entitled to be judged as much for what they built as for how they ended their reign.

Housing: Don't Panic Yet

FOLKS AREN'T DAY-TRADING houses yet, but it's starting to feel that way. Talk at the gym, over drinks, during golf, at work—nearly everywhere—increasingly revolves around real estate. The tone isn't far from the hype of the stock frenzy. What did you sell for? Can you still buy? When talk itself gets frothy, it's time to worry about a bubble.

Soaring home prices are the last remaining problem of the tech boom. The extremely low interest rates that were needed to revive the economy after the bust set the stage for a rally in housing that's now reaching extremes. Bringing the real estate market to a soft landing will not only bring closure to a previous economic era but provide the stable foundation for a

prosperous new one. A housing bust could undermine consumer spending and economic growth for years to come.

Fortunately, it looks like a bust is unlikely. An unusual balance of economic and financial forces is generating a slowdown, not a breakdown. The Federal Reserve is raising interest rates and appears ready to continue to do so for some time. Long-term mortgage rates are up to 6% and heading toward 7%, a level sure to cool off a large chunk of the housing market in many regions.

At the same time, demand for housing remains high. Immigrants continue to pour into the country and into the housing market. Twenty- and thirty-somethings continue to start families and need more space. Boomers continue to buy second homes and look for retirement properties. In fact, many people aren't even taking out mortgages for their new homes. People are cashing in options that are in the money for the first time in years, inheriting sums from their parents or just selling their old houses to generate cash.

All this upward pressure in demand offsets to a large degree the downward pull of rising interest rates in the national real estate market. Housing is slowing but not tanking. That's good. Housing has been very good financially to most Americans in recent years. It can continue to be a store of value if a crash can be avoided.



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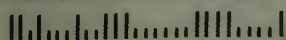
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Think IBM and you think tech services, right? Sam Palmisano has a different idea of what Blue should be



Cover Story

68 IBM: Beyond Big Blue

CEO Sam Palmisano has a strategy so bold it would be laughable if it weren't so serious. His goal: Free IBM from the confines of the \$1.2 trillion computer industry. Palmisano is deploying Big Blue's vast in-house resources, from programmers to research scientists, to help the likes of Marathon Oil and Procter & Gamble rethink revamp, and even run their businesses—everything from accounting and customer service to human resources and procurement. In short, he wants to be the makeover artist to Corporate America

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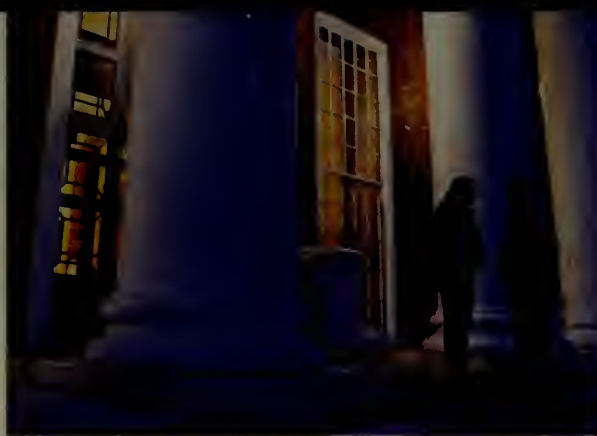
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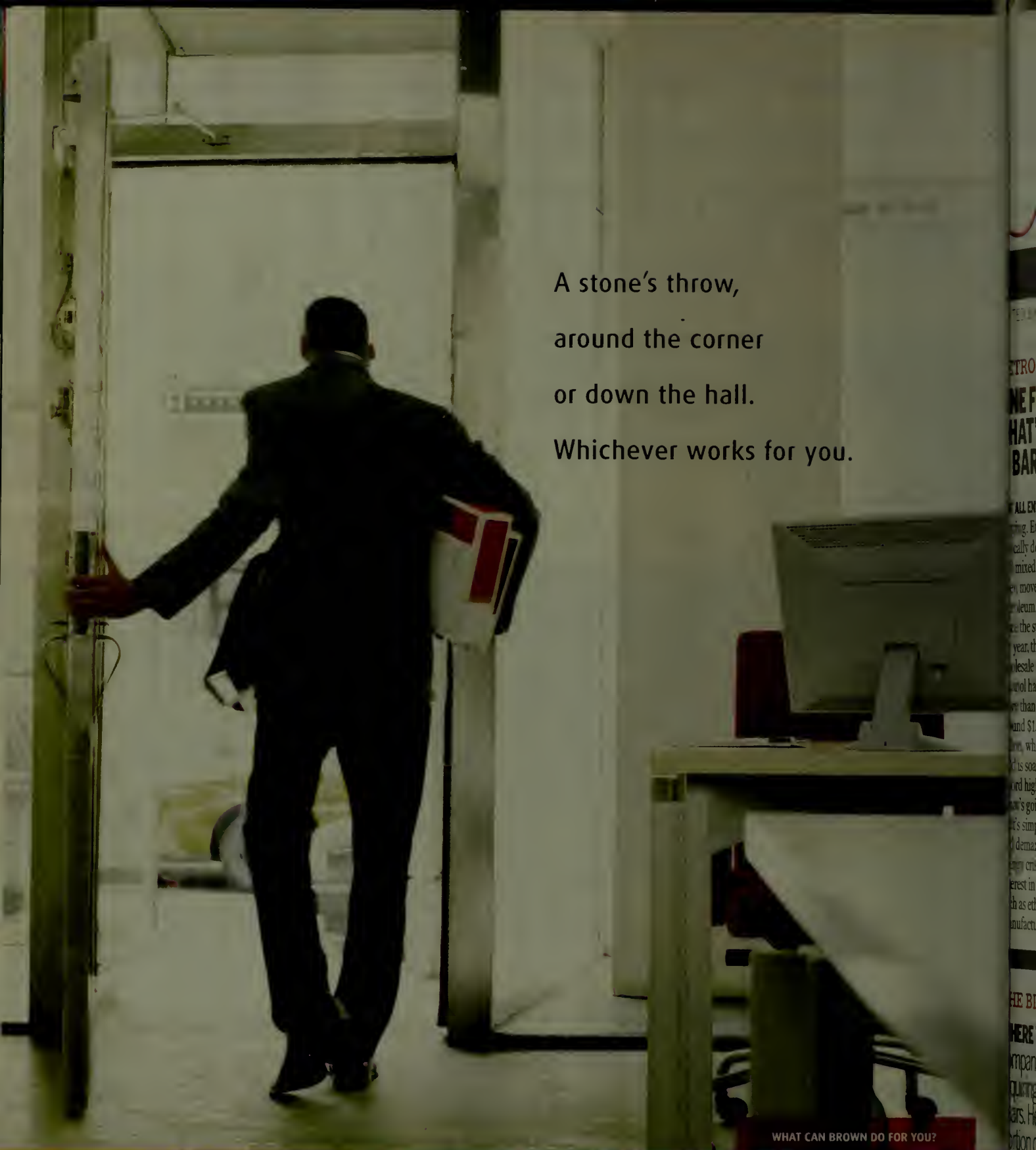
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JP Front

"The name's not an asset when you finally get down to getting the job."

—Breck Eisner, son of outgoing Walt Disney CEO Michael Eisner, discussing with AP his big-screen directing debut, *Sahara*

EDITED BY IRA SAGER

CONTROL PATROL THE FUEL WHAT'S STILL A BARGAIN

ALL ENERGY prices are going. Ethanol, which is usually derived from corn mixed with gasoline, is in moves in sync with oil. But at the start of the year, the wholesale price of ethanol has fallen more than 20%, to around \$1.20 a gallon, while black oil is soaring to record highs. What's going on? It's simply a case of supply and demand. Fear of an energy crisis has fueled interest in renewable sources such as ethanol. So manufacturers have added

huge amounts of capacity for producing ethanol. This year the industry, which includes such big players as **Archer Daniels Midland**, could turn out 4 billion gallons, up from 3.4 billion in 2004.

The customers just haven't come through yet. Politicians in Georgia, which was expected to be a big buyer of ethanol this year, have been

fighting a mandate to use reformulated gasoline. Both the Senate and House are floating bills that would institute a renewable-fuel standard, requiring the oil industry to use at least 5 billion gallons by 2012.

But so far nothing has passed. If an energy bill does find its way through Congress, though, ethanol may be a hot commodity.

—Adrienne Carter



WAYMAN
Interim CEO
at HP

WRETCHED EXCESS

Nice Work If You Can Get It

IT WAS A GOOD 52 DAYS' WORK. According to an Apr. 5 filing with the **Securities & Exchange Commission**, **Hewlett-Packard's** board has agreed to pay Chief Financial Officer Robert Wayman a \$3 million cash bonus for taking over as interim CEO after the Feb. 8 ouster of Carly Fiorina.

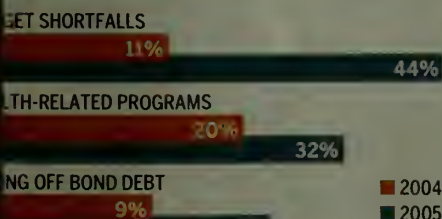
That works out to \$57,692 a day—or \$21 million on an annual basis. Mark Hurd, the former **NCR** chief who took the job on a permanent basis on Apr. 1, can make up to \$26,849 a day in salary and bonus, if he hits his top goals. (Hurd is getting \$1.4 million in salary, with the potential to earn a top bonus of \$8.4 million.)

Of course, Wayman was a steady hand during a potentially stormy period. A 36-year HP veteran, he has long been considered a top CFO—and is one of the few people who managed to stay in good standing with those on both sides of the divisive 2002 proxy fight over the **Compaq** merger.

Wayman, 59, was already well-paid. According to proxy statements, he earned \$1.5 million in salary and bonuses in fiscal 2004, along with restricted stock currently worth \$326,000. HP says the bonus is partially in recognition of Wayman's decision to put off his retirement. —Peter Burrows

THE BIG PICTURE

HERE THERE'S SMOKE In 1998 four tobacco companies signed a settlement with 46 states requiring them to pay \$206 billion over 25 years. Here's how states plan to spend a big portion of this year's \$5.4 billion allotment compared with their 2004 expenditures:



U.S. Government Accountability Office



BOARD MOVES IS BUFFETT TOO COZY WITH COKE?

IT HAS BEEN a tough time for Warren Buffett. Dragged into the hubbub at scandal-ridden **American International Group** (page 33), the Oracle of Omaha conceded he knew about a



questionable deal. Now, proxy adviser **Institutional**

Shareholder Services (ISS) again has him in its sights.

For the second year, ISS is

UNDER FIRE
He's in the food biz

asking investors to withhold their votes for his reelection to the **Coca-Cola** board in protest of his role on the audit committee. The reason: Close ties between Coke and units of **Berkshire Hathaway** allegedly undermine his status as an independent director. Buffett-owned outfits did \$185 million of business with Coke last year. Two—**International Dairy Queen** and food service outfit **McLane**—generated 0.78% of Coke revenues, up from 0.5% in 2003, nearly hitting Coke's own 1% threshold for nonindependent status.

Last year, 16% of shareholders agreed with ISS. McGurn expects that figure to jump this year, but he acknowledges ISS may not win. Coke says that Buffett's reputation for integrity—and his substantial Coke holdings—make him ideally suited to serve on the audit committee. Buffett declined to comment. —Jessi Hempel

MEMENTOS

WIVES OF WINDSOR

In the run of royal weddings, the Apr. 9 nuptials of the Prince of

Wales and Camilla Parker Bowles haven't sparked much interest from souvenir makers. So far, they have produced only 25 to 30 lines of items—such as postage stamps (above)—says the **Commemorative Collectors Society**. The contrast with Prince Charles's 1981 marriage to Lady Diana Spencer couldn't be more stark: More than 1,600 souvenir lines were made then, many of them in mass quantities. The Queen's Golden Jubilee in 2002, celebrating her 50 years on the throne, prompted 830 types of mementos. Even Prince Edward's relatively low-key marriage to Sophie in 1999 spawned 234 collector's items. —Beth Carne



EX LIBRIS

IF THE SUIT FITS, HERE'S THE BOOK

AS A BAROMETER of the upcoming onslaught of lawsuits against **AIG**, this is a pretty good one: Insurance consultant Andrew Barile has had calls from litigation departments at big law firms looking for his book *A Practical Guide to Finite Risk Insurance and Reinsurance*.

Sounds dry—but lawyers are paying \$500 a copy for the out-of-print book to get a handle on transactions like those that landed AIG in hot water with the **Securities & Exchange Commission** and Eliot Spitzer. The book, published in 1995, originally cost \$75. —Nanette Byrnes

DRAWN & QUARTERED

It was a youthful indiscretion...
I did experiment with it in college...
But I have not illegally downloaded music since...

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FACE TIME

CHRISTOS COTSAKOS



VIETNAM'S TELL-ALL ON THE MALL

It bothers former E*Trade CEO **Christos M. Cotsakos** that most visitors to the Vietnam Veterans Memorial Wall in Washington were born after the war and don't know much of the history. That's why he is leading an effort to raise \$40 million to build an educational center near the wall. Says Cotsakos, who left Vietnam's battlefield 37 years ago: "It was a character-defining moment for our nation."

Cotsakos, 56, left E*Trade in 2003 and now devotes more than a third of his time to charity. This month he'll return to Vietnam as part of a project to remove land mines.

Much of his time is also spent on Money & Living Holdings, a new company he calls "the HDTV of financial media." Cotsakos says only that it targets young people, using podcasting to zap them financial news through cell phones, iPods, and the like.

Meanwhile, Cotsakos must raise \$20 million by June, 2006, when the center breaks ground. He'll hit up ordinary citizens for funding, so watch your mailbox. —*Jessi Hempel*

HIP-HOP NATION

IS MICKEY D GETTING A BAD RAP?

SHOULD YOU RHYME Big Mac with heart attack? Probably not—not if you want in on McDonald's plan to recruit hip-hop and rap artists to feature "Big Mac" in songs. Under the plan, when a Big Mac song that McDonald's O.K.'s gets radio play, Mickey D sends the artist a check.

McDonald's pay-for-play program has divided the hip-hop community, which has been known for promoting brands such as **Cadillac Escalade** and

Courvoisier cognac without financial incentive. The deal, estimated to be in the \$1-per-play range, could add up for hit songs. Even so, Damon Dash, co-founder of **Roc-A-Fella Records**, says the deal smells bad. "If McDonald's is



BIG MAC
Musical appeal

looking for influential hip-hop artists, no one is going to touch this deal," he says.

But **Def Jam** co-founder Russell Simmons says the McDonald's deal was great before word leaked out. "It would have worked fine," says Simmons. He says if a rap artist is inspired to write about a Big Mac and there's a payoff, it's all good. "But now that the cat's out of the bag, I don't believe any big rappers will do it," says Simmons. The way to save the deal and the dollars, he says, is to write a song making fun of selling out.

Is that what McDonald's has in mind? Spokeswoman Lisa Howard says the program is still in "the conceptual stage." She says the deal should be viewed as no different from brand placement in films and TV. —*David Kiley*

DASH
Keeping it real



WHERE THE JOBS AREN'T

CULTURE CRUNCH Which part of the economy is losing jobs the fastest these days? Surprise—it's the arts, entertainment, and recreation sector, which is down by 48,000 jobs over the past year. Americans seem to be more interested in listening to their iPods, browsing the Internet, and enjoying their big-screen TVs than in playing golf or going to live performances. Even casino employment is lower than it was a year ago.

CHANGE IN JOBS*



RECREATION, GAMBLING,
AND AMUSEMENTS

-30.9



PERFORMING ARTS AND
SPECTATOR SPORTS

-15.3



HISTORICAL SITES, ZOOS,
MUSEUMS, AND PARKS

-1.9

*In thousands of jobs from March '04 to March '05

Data: Bureau of Labor Statistics



moving forward ▶

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with an expiration date.*



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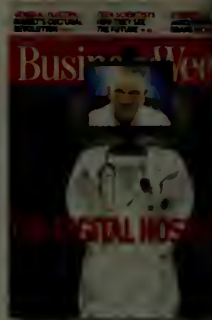
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The digital revolution is contributing to a thorough rethinking of the very design of the hospital."

—Deborah Sheehan
 OWP/P Architects Inc.
 Chicago



THE ADVANCES AND LIMITATIONS OF DIGITIZED MEDICAL CARE

"THE DIGITAL HOSPITAL" (Cover Story, Mar. 28) accurately captures one of the most significant trends sweeping the hospital industry. But there is more: The digital revolution is contributing to a thorough rethinking of the very design of the hospital. One example: Digitization shrinks the storage space needed for medical records and film. Digitized equipment for, say, mammography, can handle a greater number of patients with fewer pieces of gear in less space. Functions at large, centralized nursing stations can be distributed, putting nurses, medicine, and records closer to patients, reducing wear and tear on nursing staff and minimizing the risk of patient error. All told, digitization can spur a new-model hospital: more efficient, more technologically advanced, and more responsive to the needs of patients, families, nurses, and doctors.

—Deborah Sheehan
 National Director of Healthcare
 OWP/P Architects Inc.
 Chicago

AS A PRACTICING family physician who works in a public hospital where over

90% of the prescriptions are written electronically, I was intrigued by the implications of your cover story. Interestingly, the most cost-effective "innovation"—multidisciplinary rounds—while improved by info tech, is basically an old technique that relies on personal communication among the staff who know the patients most intimately.

Similarly, a study last year showed a 25% cost reduction from teaching family members of stroke victims how to care for their loved ones. While Information Age technological advances can help, quality health care requires personal attention to the unique human characteristics of each patient and family.

—Kenneth B. Frisof, MD
 MetroHealth Medical Center
 Cleveland

THE CENTER ON PATIENT safety at Florida State University College of Medicine recently completed a study for the state legislature on the return on investment associated with information technologies used in Florida hospitals. The study combines data collected on information-technology utilization in Florida acute-care hospitals with financial reports

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BusinessWeek

APRIL 18, 2005 (ISSN 0007-7135) ***

3929

Published weekly, except for one week in January and one in August by The McGraw-Hill Companies, Inc. **FOUNDER:** James H. McGraw (1860-1948).

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Readers Report

CORRECTIONS & CLARIFICATIONS

"This trade pact won't sail through" (Government, Mar. 28) identified Commerce Secretary Carlos M. Gutierrez as Mexican-American. In fact, he was born in Cuba.

In "How to fix the tort system" (Cover Story, Mar. 14), we miscalculated the percentage of eligible people who took advantage of a class-action judgment against Intel Corp.: 150 of 500,000 is 0.03% (not 0.0003%).

submitted to the Florida Agency for Health Care Administration. Improved financial outcomes are present when examining information technology collectively and for individual measures of clinical, administrative, and strategic information technology.

As the nation's newest medical school, the FSU College of Medicine has made a large investment in teaching medical information technology to physicians in the community and to its students. We would urge medical facilities to do the same. It is an investment that will save lives and reduce costs in the long run.

—Nir Menachemi, M.D.
Florida State University
College of Medicine
Tallahassee, Fla.

APPLAUSE AND ADVICE FOR GENERAL ELECTRIC'S IMMELT

RE "THE IMMELT REVOLUTION" (Management, Mar. 28): My father has worked at General Electric Co. his entire professional life and is a good example of how CEO Jeffrey R. Immelt's idea of specialization is sound. My father took a permanent manager position at GE Fanuc Automation in Detroit—where he has found great success—to stop us from having to move every two years, as was the sign of success in Jack Welch's GE.

I offer an idea to Mr. Immelt on how to easily tap into the creative power of some of his greatest specialists: Adopt an "internal consultant" program where a successful leader from one business is encouraged to look into the operations of another business for a short period in order to offer some outside ideas. Perhaps start an idea contest in which all employees can participate. Some of the most creative people inside GE may be working as custodians or call-center operators. Keep the doors open to anyone who has an idea for improvement.

—Carl A. Patrick
Cincinnati

KUDOS TO CEO Immelt and his innovation revolution at GE: Back to the future. Instead of the quarterly dividend, once again it's "Progress is our most important product." If he would like new fields to conquer, let me suggest an efficiency revolution in electric motors, large and small; development of superconductivity for commercial use; advanced concept batteries and motors for hybrid vehicles; materials research leading to higher-efficiency solar cells and mirror systems; maglev train development (China has one in operation); safe, efficient breeder reactor power plants—with better solutions for nuclear waste; cost reduction in high-tech medical-diagnostic equipment; and efficient, economical fossil fuel power-plant exhaust scrubber systems for China, developing countries—and the U.S.

Why not find out what industries could benefit from robotics solutions and then develop them? And how about sponsoring summer internships for bright U.S. high school science students?

GE could be responsible for strengthening our high-tech industrial base, for creating thousands of new jobs, for a

stronger economy and improved environment. Not bad for one corporation.

—Lee G. ...
Philadelphia

KIDS NEED EXPOSURE TO SCIENCE EARLY AND OFTEN

WHILE INITIATIVES such as Corp.'s are important ("Meet the best brightest," Science & Technology, 28), it's clear that government and industry should do more to promote science a career, since failure to do so could have drastic consequences for economic growth in the decades to come. Links between industry and education ought to start much earlier in students' careers. Just as it is important in a child's development to be exposed to different cultures and languages, so should exposure to the basic principles of science—Newton's law of motion, for instance—be a compulsory part of children's education.

With this kind of early exposure to science we might see less of a fear of science in teenagers, with fewer young people pressing the view that science is "boring" or "too difficult." Not only does a career



nce-based industries offer young people wider opportunities in other parts of world than careers in banking, insurance, and law, it also instills in them a spirit of rigor and scrutiny that will ensure that they become innovators of the future.

—Thomas White
President

Operations Support Systems Group
Agilent Technologies Inc.
Wokingham, England

THE LOGIC, EMOTION AND BIOLOGY—OF ECONOMICS

“WHY LOGIC often takes a backseat” (Economic Analysis, Mar. 28): While most economists are busy fighting each other over rationality, a third group seeks reconciliation using insights from an unlikely source: biology. These biological economists are led by Nobel prize winner Professor Vernon L. Smith of George Mason University, and they have generally operated below the radar screen. This innovative work seeks a biological source for our irrationality. The answer, current research suggests, is that the back of the human brain is built to solve the prob-

lems of our distant ancestors, who lived in a world without bank accounts, credit cards, or Social Security.

—Terry Burnham
Cambridge, Mass.

Editor's note: The writer is the author of *Mean Markets and Lizard Brains: How to Profit from the New Science of Irrationality*.

NEUROECONOMICS IS indeed on the right track. However, it is my opinion that, like the logical side of the brain, which is more obviously mathematical, the emotional side is also mathematical. In simplistic terms, the logical side deals with the finite, while the emotional side deals with the infinite. Since both the finite and infinite are mathematical, their interplay is mathematical also. Hence, any decision that doesn't include consideration of the emotional side of an issue (be it economic or otherwise) is not even “logically” sound.

—Joseph Oppenheim
San Diego

BOTH NEUROECONOMICS and behavioral economics seem to face a common problem: The smart money, such as War-

ren E. Buffett, may not think or behave like typical market participants.

—Charlie Stromeyer Jr.
Concord, Mass.

TO GET GM MOTORING SMOOTHLY, TRY... BANKRUPTCY?

AFTER DESCRIBING the mess that General Motors Corp. is in (“Running out of gas,” News: Analysis & Commentary, Mar. 28), *BusinessWeek* asks: “What must GM do to turn itself around?” First, spin off the profitable GMAC financing division and distribute the proceeds entirely to the stockholders. Then run GM strictly as an automotive business. Yes, this will lead to bankruptcy in short order. But the restructuring will give GM the opportunity to learn how to design and manufacture cars again, and it will also enable management to obtain sane labor contracts.

—Peter Skurkiss
Stow, Ohio

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BY ROBERT KUTTNER

Beware a Sales Tax in The Name of Simplicity

President Bush is having a difficult time selling Social Security private accounts to America's middle class. But just wait for the backlash when he proposes his tax reforms. Pack-

aged as tax "simplification" and savings incentives, the likely changes would shift the tax burden from the rich who tend to have more (they have more to save) onto the middle class.

As people rush to meet the Apr. 15 tax deadline, a tax commission appointed by President Bush is laboring to produce recommendations toward the President's stated goals of simplifying taxes, maintaining revenue neutrality, and promoting

savings and growth. This charge is a mission impossible.

It's an open secret that the commission is expected to offer a blueprint for the longstanding conservative goal of shifting taxation from income to consumption. The simplest mechanism would be a national sales tax. Unfortunately, to be revenue-neutral it would also require a sales tax rate of about 60%, according to calculations by William Gale of the Urban-Brookings Tax Policy Center. That's because taxable retail sales are less than a third of all economic activity. A revenue-neutral national sales tax would produce a massive shift of the tax load on to middle- and lower-income taxpayers. So it's a political nonstarter.

Rather, the commission is likely to pursue consumption taxation by stealth and indirection. By leaving the income tax nominally intact, but chipping away at taxes on capital

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come, the commission could produce a blueprint for a de facto consumption tax. Consumption-tax advocate Ernest S. Rostow terms this approach Five Easy Pieces: Don't pursue consumption taxation directly, but slash taxes on capital gains and dividends, estates, all savings, and allow business to expense investments.

This scheme is nimble, but it defies all three of the President's stated goals. First, far from simplifying the tax code, it would add to its complexity. Even if tax deductions for savings were consolidated, it is not IRAs and Keoghs that are cluttering up the present tax system.

Second, this approach would not increase the national savings rate. The new shelters would increase deficits in order to give well-to-do taxpayers yet another tax break. Anyone who has ever shifted ordinary savings into an IRA or Keogh knows that tax preferences for savings do not increase savings rates. They just give you a tax break for moving sound assets.

Thus, this approach cannot be revenue-neutral unless, like a national sales tax, the formula increases taxes on wage and salary income. The problem is compounded by the mother of all stealth tax increases, the alternative minimum tax. This device, legislated in 1970 to prevent very high-income taxpayers from avoiding taxation entirely, now hits most upper-middle-class taxpayers, by limiting such deductions as local property taxes. For upper-middle-income taxpayers in the \$100,000-\$300,000 bracket, mostly Bush supporters, the recent tax increases caused by the AMT often exceed the

savings of all the Bush tax cuts. But reforming the AMT will cost the Treasury an estimated \$1 trillion over the next decade. So the commission cannot fix the AMT without raising other taxes or increasing the deficit.

Taxes on consumption would hurt the middle class and the poor

If Bush had pursued consumption taxation early in his Presidency, before squandering so much revenue on other big tax breaks, he might have pulled it off. But a massive revenue loser is implausible in the current fiscal climate, and a big tax hike for the middle class is inconceivable.

Meanwhile, the Democrats have managed on Social Security something that eluded them throughout Bush's first term—unity in opposition to a key Bush goal. Few if any Democrats will support a tax hike for the middle class, and many Republicans will think twice.

Jumping the gun on Bush, the liberal think tank the Center for American Progress has rolled out a tax-simplification plan that could become Democrats' rallying point. Unlike the Bush plan, CAP's plan cuts most people's taxes, provides genuine simplification of the tax code, and raises net revenue.

The White House had hoped to gradually generate public support for consumption taxation, building on an anticipated big win on Social Security privatization. But with his Social Security plan in trouble, Bush could instead face two high-profile, back-to-back defeats. ■

Robert Kuttner is co-editor of *The American Prospect* (rkuttner@prospect.org).

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Welch Has More to Say. Really

WINNING

By Jack Welch with Suzy Welch; HarperBusiness; 372pp; \$27.95

When Jack Welch retired from General Electric Co. in 2001, much of the world was already familiar with the inner workings of his brain. Of course, Welch is one of the most celebrated corporate leaders of the 20th century, and his beliefs and business strategies have been well-chronicled in dozens of books. He

soon released an autobiography, too. So it was hard to imagine that the retired chief executive had that much left to say. Indeed, *Winning*—written with Suzy Welch, his new wife and former editor of *Harvard Business Review*—does delve into subjects that can only be described as vintage Welch. For example, there are chapters on the Six Sigma quality push, motivating people, firing them, and creating a culture that thrives on change.

That said, there's much here that might not have been anticipated. His separation from the industrial and financial behemoth—along with, perhaps, the influence of his co-author—seems to have done wonders for Welch's perspective. He considers a broad range of topics gleaned from questions posed on the speaking circuit, such as the challenges facing working mothers or how to operate in China's autocratic business culture. He even reflects on his mistakes and comments on current events. All of this is offered in the breezy, blunt style that was his hallmark at GE. The result is a guide that's more candid and accessible than earlier works by or about Welch.

Winning has four main sections. The first outlines Welch's basic business philosophy: the need for clear and tangible values, for extreme candor in the workplace, for strong differentiation among employees, and for ways to bring every staffer into the game. While such tenets aren't new, they could hardly be omitted, as they are key to understanding Welch's record at GE. The next three sections cover winning within a company, against the competition, and over the course of a career.

"Your Company" taps most into Welch's sweet spot. Here he lays out his leadership philosophy—"success is all about growing others"—and outlines the characteristics that earned him accolades. Ever the teacher, he provides several rules per chapter, elaborating on each one with examples: The 2004 World Series win of his beloved Boston Red Sox shows how leaders must relentlessly upgrade their teams. Welch also gets into the grit of hiring, talks about the need to give human-resources departments real power, and reiterates his long-held view on the necessity of firing nonperformers on the grounds

that all concerned will benefit. He rounds out this section with tips on crisis management, drawn from his own failures.

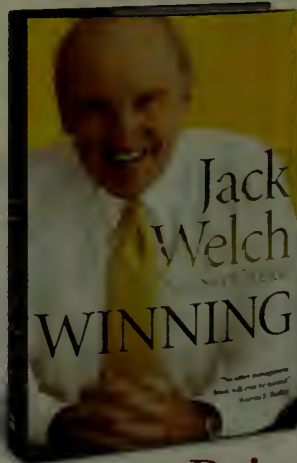
"Your Competition" initially seems intended for ambitious managers. But all readers will discover value in Welch's iconoclastic take on such themes as strategy and budgeting. What elevates these chapters above the usual trite tips is Welch's success in reshaping GE's business model. Budgets, he argues, should be less about making your numbers and living within your means than beating last year's performance and besting competitors whom you truly understand. New projects can wither without hungry leaders, top-level cheerleading, and true freedom. Welch has a provocative gloss on the pitfalls of mergers, and he even renders Six Sigma palatable.

The section that may appeal to the most readers is "Your Career." There's a clear-cut analysis of how to find the right job, along with a consideration of how to get promoted. But the most fascinating bit concerns work-life balance, a subject that rarely hit Welch's radar at GE—which may help to explain the dearth of women in his senior ranks. Welch admits to being a lousy father with little concern for others' family responsibilities. What distinguishes this account is its frank axiom: Flexibility on the job is something you earn via superior performance. As he puts it: "Even the most accommodating bosses believe that work-life balance is your problem to solve." If they're passionate about you, they'll adapt to your needs. Tough, maybe, but true.

The merit of each section depends, of course, on the reader's situation. Welch has aimed broadly—hoping to woo everyone from the success-hungry college grad to the senior-level executive. That's ambitious. Fortunately, he keeps the interest level high by interweaving common-sense strategies with dynamic examples and personal reflection.

Winning ends with a string of quirky questions people have thrown at Welch over the years, such as: Do you plan to enter politics? (Never.) How's your golf game? (He has stopped playing because of back problems.) Do you think you will go to heaven? (He'd rather not find out anytime soon.) Such stuff seems tangential, but its inclusion should be no surprise—this is, after all, Jack Welch. While his star may have faded amid publicity of his divorce and lavish retirement package, he still revels in the spotlight. Luckily, Welch seems to have more insights and wisdom to share. ■

— By Diane Brad



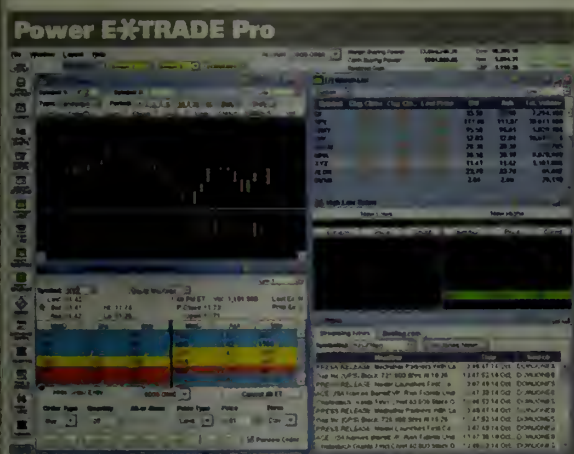
Being away from GE has done wonders for Welch's perspective

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BY STEPHEN H. WILDSTROM

The New Bluetooth: More on the Beam

When the short-range wireless technology called Bluetooth first appeared about five years ago, it was hyped as a way to finally sweep all those messy cables from our lives. Then cost and complexity took their inevitable toll, and many people wrote the technology off. Now Bluetooth is back, and it has become a useful tool in a variety of settings.

Bluetooth has had more success in Europe than in the U.S. It's standard on nearly all high-end European handsets. And Europeans were quick to adopt accessories such as cordless headsets for phones and laptops, wireless keyboards and mice, and more.

Today in the U.S. you'll find Bluetooth on many phones sold by Cingular and T-Mobile, since these carriers use the same technology as most of the rest of the world. Bluetooth is rarer on handsets from Sprint and Verizon

Communications, which are based on technology used mainly in North America.

Laws requiring hands-free phones in automobiles are speeding the adoption of Bluetooth. In the best setups, such as the one found in the Acura TL, Bluetooth integrates the handset with the car so the stereo system serves as a speakerphone, and call information is displayed in the instrument panel. Starting at about \$100, Bluetooth car kits are also available from Motorola, Nokia, Parrot, and others. Even the simplest creates a hands-free speakerphone.

HIGH COST AND POOR BATTERY LIFE made early Bluetooth headsets for phones unattractive. But now you can get a Logitech Mobile Bluetooth headset for under \$50. And the \$140 Jabra BT800, which lets you control many cell-phone functions on the headset, offers six hours of talk time and five days of standby. After that, you can recharge by running a USB cable from the headset into a laptop so you don't need to take a charger with you. A headset on the way from Plantronics will come with adapters that allow charging from most phone adapters or from an AA battery.

Bluetooth is also moving beyond hands-free phone use. Although Microsoft is a "promoter member" of the Bluetooth Special Interest Group that is responsible for the standard, Bluetooth support in Windows remains primitive. Not so with Apple Computer. The technology is standard in many Apple Macintoshes and optional in the rest, and with



**JABRA BT800
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its new line of PowerBook laptops, Apple is the first to use a new, faster version of Bluetooth. If a Mac detects a Bluetooth keyboard and mouse during setup, it will automatically link to them.

PalmOne is also a Bluetooth enthusiast. Because palmOne's software overcomes most of the Windows difficulties, I had little trouble setting up a Treo 650 Palm phone and a Tungsten T5 PDA to sync and swap files with a Windows laptop over Bluetooth. Making sync work with a new Mac PowerBook is even easier. As for

Microsoft's world, it is possible to get a Pocket PC to sync with Windows over Bluetooth, but only the technically savvy should try it.

Bluetooth still falls short in some areas. Early promoters promised that you could walk up to a Bluetooth printer with your laptop, hit a button, and print. But the software to enable this never materialized. Bluetooth printers remain scarce, though a new

Apple uses a faster version that makes syncing and swapping files a breeze

generation of Bluetooth-equipped camera phones may revive interest. And some U.S. phone carriers limit the capabilities of Bluetooth. For example, you can't use it on a Verizon Motorola V710 to transfer photos to a computer—you have to use Verizon's photo-transfer service instead.

We technology watchers are an impatient lot who tend to give up on anything that doesn't catch on right away. Bluetooth has proved once again that acceptance can take a long time—and that sometimes it's worth the wait. ■

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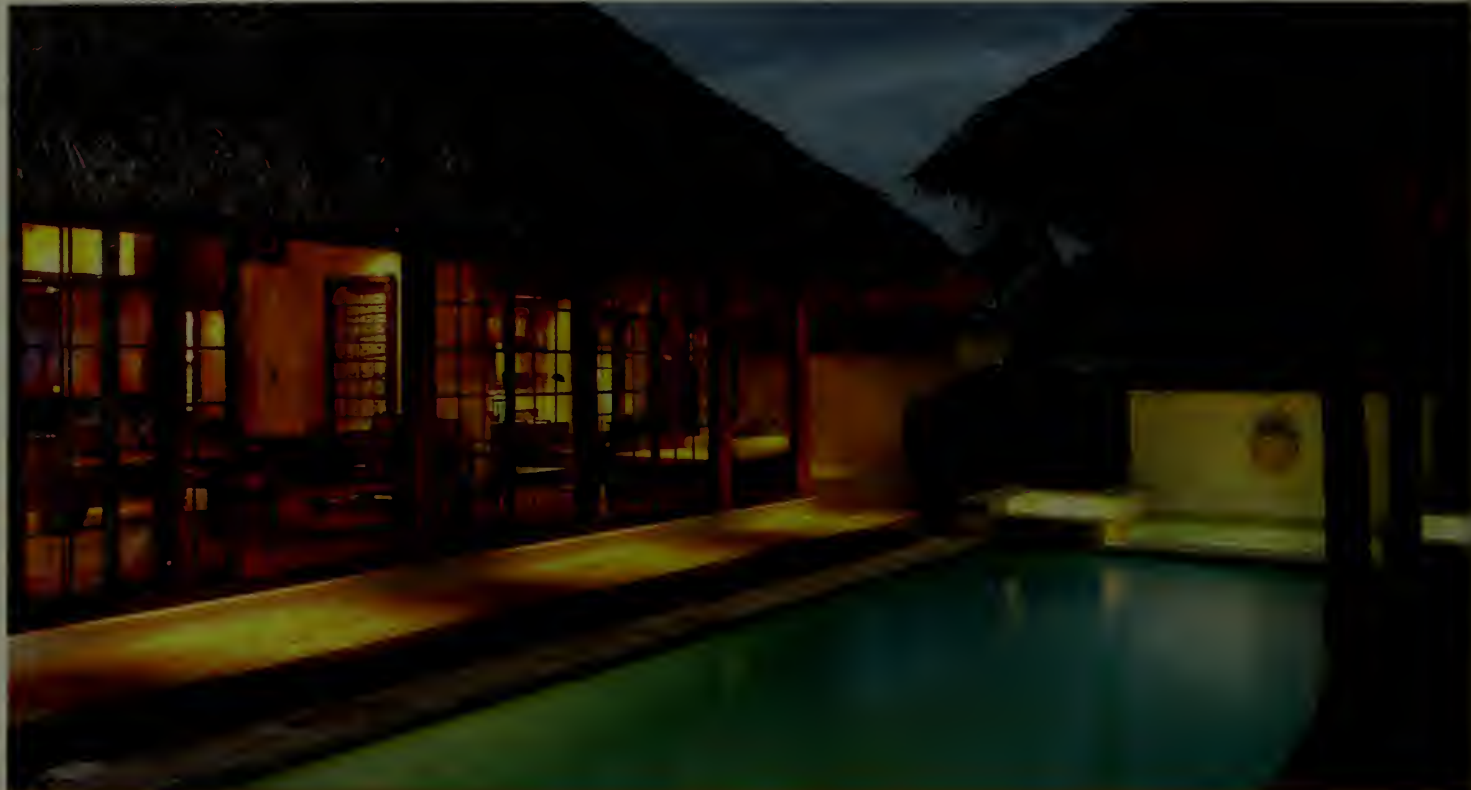


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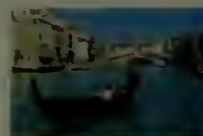
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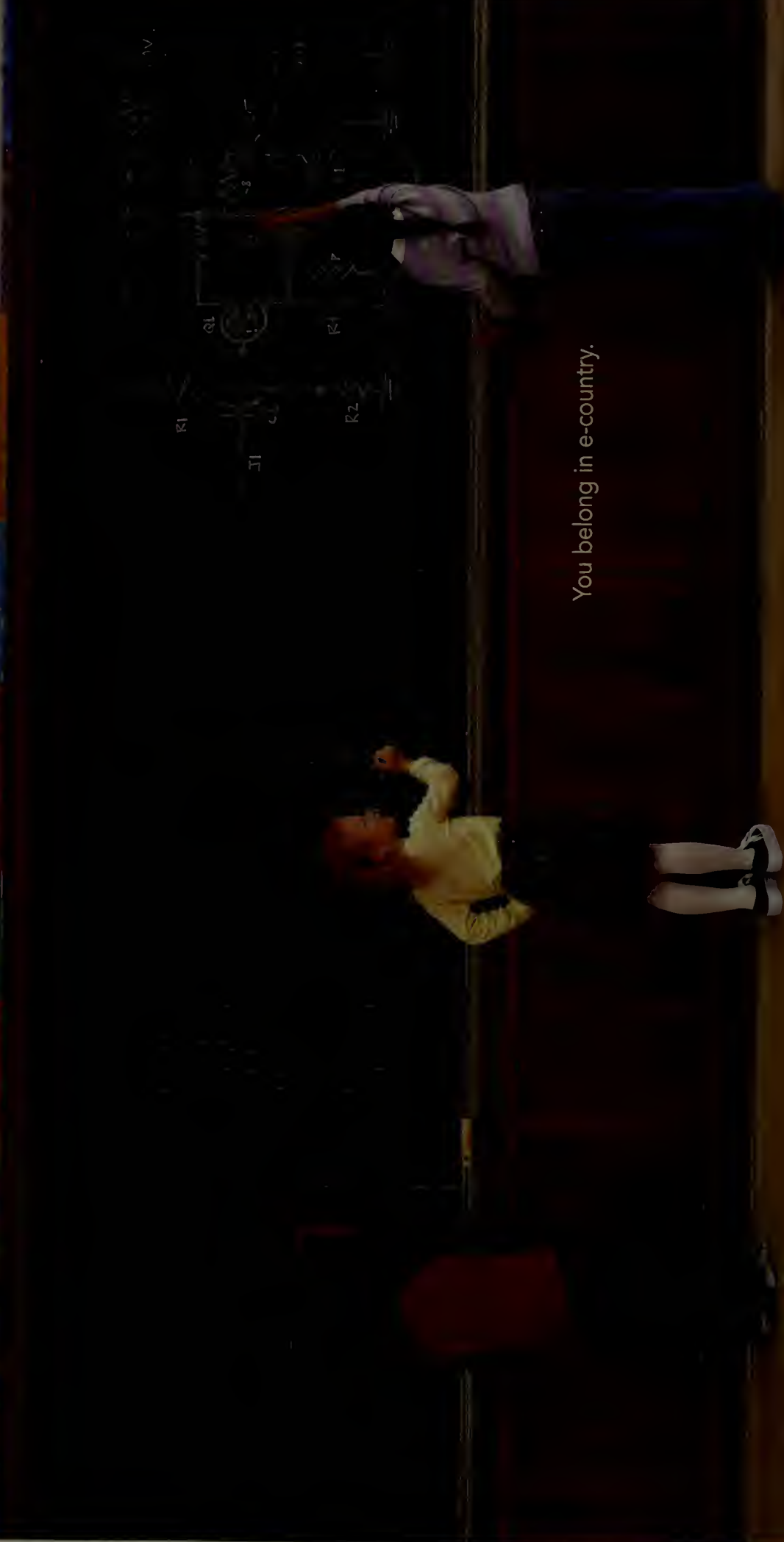


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BY JAMES C. COOPER & KATHLEEN MADIGAN

Why Profits Are Defying Gravity

More pricing power and better foreign earnings will fuel the bottom line

U.S. ECONOMY For baseball fans, April means Opening Day. For investors, it means another earnings season is in full swing. But regardless of which company you're rooting for, a broader trend in corporate profits bears watching as the year develops: Since the second quarter of 2003, earnings have consistently surprised analysts

on the high side of expectations, and several forces—some old and some new—are in place to keep profits growing at a healthy clip.

Last year, analysts and strategists concluded that the profits bonanza was over and that investors should ratchet down their expectations for earnings growth into single-digit territory. Yet at the end of last year, fourth-quarter earnings for the Standard & Poor's 500-stock index grew close to 20% from the year-earlier quarter. Now analysts expect the gain in first-quarter earnings to average 8.2%, according to the latest survey by Thomson First Call. It's a good bet that profit growth will beat that projection as well.

To be sure, earnings growth is slowing. That's a typical trend when an economic expansion matures. Plus, it's increasingly difficult to rack up strong gains compared with the zowie levels posted in the previous year.

However, a few factors are at work that many analysts didn't count on. True, productivity has slowed, but it hasn't collapsed, as businesses remain intent on managing their costs in highly competitive markets. That's why, as the March employment report showed, job growth is still the slowest of any post-World War II recovery. Also, an increasing percentage of profits is coming from operations abroad, not only due to the favorable effects of the dollar's decline and new tax treatment of foreign earnings but also because of the greater presence of U.S. businesses in foreign countries.

Perhaps most important, demand by consumers and businesses remains much stronger than expected, a factor that has fostered a new trend: greater pricing power. The ability to lift prices will help to offset rising costs and to allow further expansion in profit margins.

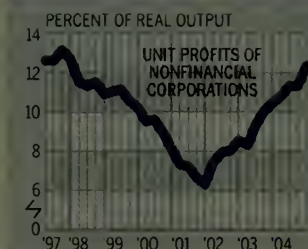
THE ECONOMYWIDE ROUNDUP of fourth-quarter corporate profits from the Bureau of Economic Analysis highlights several of these points. The BEA data encompass earnings from thousands of companies and are adjusted for consistent treatment of inventory values and depreciation, as well as seasonal patterns.

Some bounceback from the third-quarter showing was expected. Hurricane losses had caused earnings to drop 4.8% from the second quarter. What was not expected was that fourth-quarter earnings would

rebound by a hefty 13.5% from the summer, the largest quarterly increase in 12 years. The gain left profits for the full year up 15.7% from the year before, close to the 16.8% pace for all of 2003.

Even after adding the BEA's \$79.7 billion estimate of hurricane losses back into the third-quarter level, fourth-quarter profits were up by 5.9%, the best showing of 2004.

PROFIT MARGINS HIT A SEVEN-YEAR HIGH



Data: Bureau of Economic Analysis, Global Insight Inc.

In addition, profit margins widened sharply. Profits per unit of output for nonfinancial companies rose to 12.3% in the fourth quarter, the highest in seven years (chart). What this means is that businesses are making more profit from every unit of output sold.

Fatter margins highlight what's new about profits. Although

cost-cutting never goes out of fashion, companies are more vigilant about costs than was generally expected for 2005. And on top of that, businesses are enjoying better pricing power than was forecasted.

YOU DON'T HAVE TO LOOK any further than the slim rise of 110,000 jobs in March to see that companies remain cautious about the cost of new hires and that they are not about to let productivity growth slip too far.

For the quarter, overall hours worked increased at a 2% annual rate from the fourth quarter. If the economy grew by about 4% last quarter, as is widely anticipated, productivity would appear to have risen at about a 2% clip. That pace is a slowdown from last year, but it's still close to the elevated long-run trend of recent years. For profits, productivity growth at that rate will help to hold labor costs in check.

But cost consciousness doesn't explain all of the surprisingly small rise in March payrolls. Some of the shortfall from the expected gain of more than 200,000 may be simply the normal ups and downs in the monthly numbers. Note that, in the past year, monthly gains have

ranged from 83,000 to 337,000, for an average increase of about 180,000 per month. That clip is far below the average pace seen at this stage of past expansions, an indication of the new corporate mindset on costs.

Corporations are keeping an eagle eye on holding down their labor costs because the prices they're paying for other goods and services are inching up all along the production pipeline. The latest reports from the Institute for Supply Management show service and manufacturing companies are paying more for materials and services.

For manufacturers alone, the ISM's price-paid index jumped from 65.5% in February to 73% in March, the highest reading since November. Of course, one company's higher production costs are another's pricing power. A survey of 1,600 small-business owners by PNC Financial Services Group showed that 50% planned to raise prices in the first half, up from 34% last fall. And coming at a time of modest unit labor cost gains, that power will create a double lift to profits in 2005.

ANOTHER INCREASINGLY CRITICAL aspect of the U.S. profit outlook is globalization. U.S. multinationals have been racking up a record level of profits from their foreign operations, prompting them to invest even more in their overseas affiliates. That trend should continue in 2005, in part because of the dollar's continued decline and because U.S. multinationals view overseas economies as the best new sources for revenue.

In 2004, profits of U.S. corporations earned in the U.S. rose 7%, while U.S. receipts from the rest of the world

increased by 26% (chart). Although foreign receipts make up about 30% of all profits of U.S. companies, that share is rising, and last year earnings from abroad accounted for 58% of the growth in the earnings of U.S. businesses.

Given the recent surge in overseas direct investment by U.S. companies, it's not surprising that foreign earnings

are soaring. Robert J. Barbera, chief economist at consultants Hoenig, believes the rise in foreign earnings reflects "the role U.S. multinationals are playing in the boom in Asia." The flip side of this trend is that "the earnings gains are generating strong investment and employment in Asia, not



the U.S.," notes Barbera. His observation connects the dots to how a better profits outlook will keep job growth from matching the strong performance of past recoveries.

However, bear in mind that job growth in 2005 will be the strongest for any year so far in this expansion. The economy is balancing out the benefits of growth for both workers and businesses. And when the rush of first-quarter earnings reports begins, don't be surprised if a lot of companies, especially multinationals, hit some expectations out of the park once again. ■

ITALY

What's Keeping the Brakes on Growth

DID THE ITALIAN economy shrink for a second consecutive time in the first quarter? The monthly data seem to hint that business activity contracted again over the winter.

The latest news shows that business confidence in March fell to its lowest reading since July, 2003, with drops reported in orders and production. Consumers also felt gloomier last month, with their confidence index falling for the fourth time in five months. March car sales fell 8.6% from year-ago levels. And the purchasing managers' index for the service economy averaged 52.3% in the first quarter, below its 53.4% reading in the fourth quarter.

A contraction in the

first quarter would follow a downward revision to real gross domestic product at the end of 2004. Fourth-quarter real GDP fell 0.4%—not the 0.3% first reported.

The big drag on growth is coming from exports, which are being hurt by the rising euro, while manufacturers are facing higher costs, especially for energy. Exports account for about 30% of Italy's economy.

On Apr. 4, the European Union pared its forecast for Italy's 2005 growth to just 1.2%, from 1.8%. And Italian Finance Minister Domenico Siniscalco recently said growth would come in at just 1.5%, far short of the government's previous target of 2.1%.

Even a 6 billion euro (\$7.8 billion) tax cut has not boosted consumer spending this year. But the cut exacerbates Italy's fiscal problems. The euro zone's new Stability & Growth Pact gives more leeway to deficit-ridden nations such as Italy, Germany, and France. However, the agreement frowns on one-time budget fixes. And the government's plans so far seem to be more asset sales to reduce debt. The latest holding on the block is another 11.5% stake in energy company Enel.

The economy's woes are giving Prime Minister Silvio Berlusconi political problems. His Forza Italia party lost ground in the April regional elections. He has vowed to pursue more tax cuts this year. The aim is to pump up domestic demand to offset the export slump. But it is no coincidence that the cuts, if passed, would come before Berlusconi stands for reelection in 2006. ■

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B-SCHOOLS

MBA APPLICANTS ARE MIA

As tuitions soar and the job market strengthens, some B-schools are downsizing—and all are getting less selective **BY JENNIFER MERRITT**

WHEN THE DEANS of seven of the top U.S. business schools got together for their biannual meeting on a chilly, gray day earlier this year, the usual topics of conversation—MBA recruiting, new courses, and leadership training—quickly gave way to a gloomier subject. According to people privy to the secretive meetings, the men, gathered at an Ivy League campus, solemnly broached a sensitive topic: Applications for the class entering in the fall would be down—just as they were last fall. Rumors were whispered that some schools in the top tier might not fill their classes. One dean was even called out for deciding not to report applicant

and selectivity numbers.

Indeed, applications to *BusinessWeek's* Top 30 MBA programs have dropped almost 30% overall since 1998, with some schools seeing declines of 50% or more. And with the job market improving, more prospective applicants may find themselves with opportunities that will, if history is any indicator, pull them away from B-school.

What's more, to cope with sliding interest, some schools have gone so far as to quietly reduce the number of students they enroll each year, *BusinessWeek* has learned. Carnegie Mellon University's Tepper School of Business has cut its class size from 240 students to a target of 160. Vanderbilt University's Owen School of Management dropped from 220 to 180 students per class. Other schools have done

the same. "We're seeing more of our peer schools competing with us for the same students," says James W. Bradford, dean at Vanderbilt. "Schools are setting new expectations based on what the market is." Even as they're downsizing their expectations, some schools that were historically highly selective, admitting fewer than 20% to 25% of applicants, gave a thumbs-up to 35% or more applicants for the class entering last fall. Vanderbilt, for one, admitted some 68% of its applicants in 2004—up 30 points in just four years.

WILL SOME GO UNDER?

THESE TROUBLES COME at a time when MBA programs find themselves facing one hurdle after another. Blame for not being a stronger bulwark against corporate scandal and poor business ethics is still being

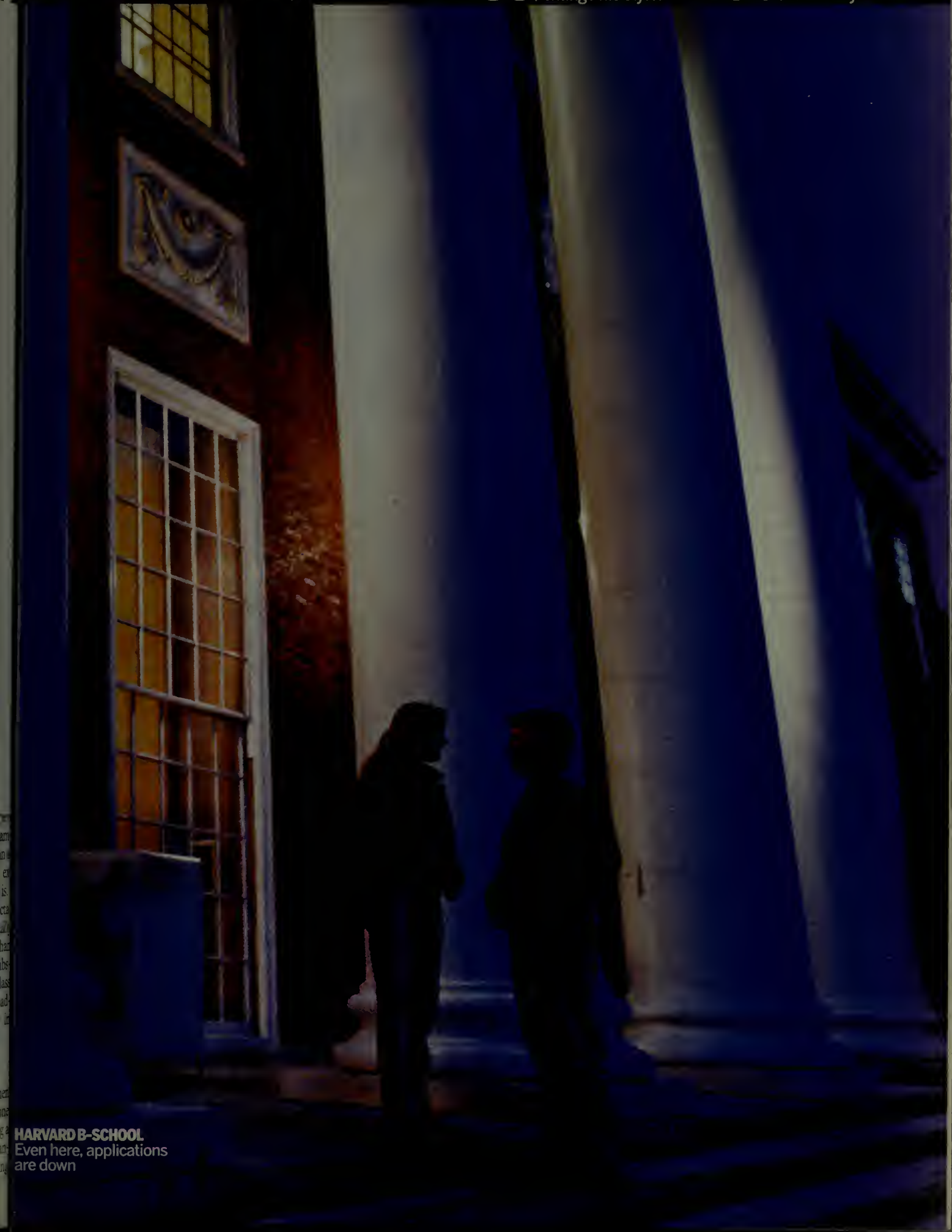
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HARVARD B-SCHOOL
Even here, applications are down

hurled at the schools. Tuition is skyrocketing—as high as \$39,100 a year at Harvard Business School,

CHICAGO
Financial aid hasn't kept pace with hikes

where applications were down 16% in 2004 over 2003. And post-MBA salaries have stagnated, stuck at an average of around \$84,000, giving many wannabe MBAs pause. Plus, competition from European schools for bright Americans has U.S. schools on edge. Foreign students, once a dependable presence, have trouble obtaining visas to attend U.S. B-schools post-September 11. Add to that a shift in hiring, with employers recruiting more undergrads and industry types, and B-schools find themselves beset by worries. No wonder one dean at the B-school powwow questioned aloud whether all of the Top 30 MBA programs would make it through this protracted slump, sources say. Admitted another dean, according to reports: "This is a serious problem."

Perhaps the toughest issue is soaring tuition. At top-tier schools, tuition is up nearly 55% over the past six years, to an average of \$33,774 for each of the two school years. And students bear far more than the cost of the degree. With an average of five years' work experience, the typical 27-year-old student gives up an average pre-MBA salary of about \$67,000.



tion 6% to 8% each year for the past five years and has seen applications go down for two straight years. "If the [loan] does not cover all of the costs, some people literally cannot put a package together to come." At most schools—Chicago included—scholarships and other financial help haven't kept pace with tuition hikes.

Having piled up all that debt, MBAs

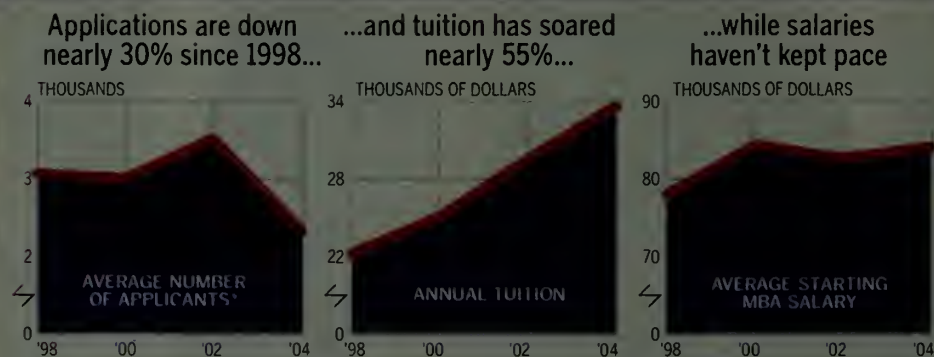
University of Michigan's Ross School of Business. "We have to be very concerned." In *Business Week's* survey, MBAs in the Class of 2004 at University of Pennsylvania's Wharton School said they had amassed nearly as much in loans as they were getting in base salary—more than \$73,000 in average debt vs. around \$95,000 in salary. Reported a 2004 grad of New York University's Stern School of Business: "Those considering an MBA should be sure the job waiting at the other end is worth the sacrifice."

Meanwhile, European schools have managed to capture some of the fall-off. Many report growing interest among U.S. applicants over the past several years. Beyond offering a diverse student body and better exposure to global business practices, European

MBA programs are shorter—about 14 to 16 months—and tuition rates, despite the weak dollar, promise significant savings. The total cost for the whole experience tops out at around \$58,000—less than the cost of one year at many U.S. schools.

Another more subtle but no less potent trend is undermining the MBA: employers hiring and promotion practices. No longer is it de rigueur for young corporate up-and-comers to apply to B-school after four years on the job. Now managers are promoting some superstars without the degree. "A lot of recruiters ask me if their best people need to go back to business school," says R. Glenn Hubbard, dean of Columbia Business School. "I argue that they should...but there will always be people who will be successful without it."

BELEAGUERED B-SCHOOLS



*FOR THE BUSINESSWEEK TOP 30 SCHOOLS; CHICAGO AND DARTMOUTH DID NOT REPORT FOR 2004, MIT DID NOT REPORT FOR 2002, CARNEGIE MELLON DID NOT REPORT FOR 2001, STANFORD DID NOT REPORT FOR 2000

Data: BusinessWeek, B-schools

MBAs also fork over cash for everyday expenses such as housing, food, and utilities—costs that are also on the rise. Schools such as Columbia Business School in New York City and Stanford Graduate School of Business in Palo Alto, Calif., recommend that single students budget more than \$64,000 a year.

Increasingly, that's looking prohibitive. Students "are bumping into their loan maximums," says Edward A. Snyder, dean of University of Chicago's Graduate School of Business, which has raised its tu-

want to count on a healthy premium in their post-degree salaries. But these days there's no guarantee. Salaries have barely budged in the past six years. After shooting up from \$77,800 in 1998 to about \$84,250 in 2000, they have been fairly flat, with average base pay for 2004 grads ringing in at \$84,030. "It's one thing if you're getting a big signing bonus and salary [in banking], but there are people who imagine B-school is a good thing to do, then they do the math, and it doesn't compute," says Robert J. Dolan, dean of

PROMOTING FROM WITHIN

GOLDMAN SACHS & CO. finds those people increasingly to be the norm rather than the exception. The investment bank is one of several companies to launch internal studies on whether MBA hires do better than undergrads who get internal training and promotions without the MBA. The kind of training Goldman and others provide is part of the growing array of management education alternatives chipping away at the traditional MBA, from hybrid, on-and-off-campus degrees to online and other executive courses.

Over the past five years or so, many nameplate companies that had previously

BusinessWeek online For more on the B-schools' troubles, see businessweek.com/extras.

heavily recruited MBAs have altered their hiring mix. Large consulting firms such as McKinsey & Co. are ratcheting down the percentage of new MBA hires and adding more undergrads and industry professionals. Goldman went from hiring about 25% undergrads and 75% MBAs for each year's group of hires to exactly the opposite since 2000. "Now we try to figure out how many analysts we can promote, and we fill in with

MBAs," says Aaron Marcus, head of campus recruiting. Concedes Chicago's Snyder: "This [shift] is fundamental, not cyclical—hiring non-MBAs is something companies have become more comfortable with."

The full-time MBA isn't going to disappear anytime soon, of course. But the need for change is increasingly clear, and reform efforts need to go beyond the cosmetic. Schools might consider adding

more depth to their offerings, even at the expense of some breadth. Alumni fundraising for scholarships could be stepped up to help meet rising costs. Schools also need to find ways to break through recruiters' growing feeling that even top-tier MBAs are becoming a commodity. Figuring out how to combat the forces at work against them may be B-schools' most pressing assignment. ■

B-SCHOOLS

Where MBAs Learn The Art of Blue-Skying

If you are looking for a business school that teaches you how to think creatively, design new products and services, manage your innovations through a corporate bureaucracy, or present them to outside angel investors, Fontainebleau, France-based Insead, the leading European B-school, just outside Paris, may be just the place. Insead has joined with the Art Center College of Design in Pasadena, Calif., to offer a joint program that teaches the role of creativity in business decisions, how innovation really works, and why design may be as important to corporate management today as Six Sigma was in the '90s. A Swiss trustee who sits on both boards brought them together.

Insead's curriculum addresses what is now the hottest area of demand in Corporate America: managers who can manage creativity, not just process. As General Electric Co., Procter & Gamble Co., and other U.S. corporations shift their focus beyond quality and efficiency toward innovation, demand for managers who understand "right-brain" creativity is soaring. "I've been teaching the Strategies for Product and Service Development course for 3½ years, and I see the limitations of not having practical design skills," says Manuel E. Sosa, Insead professor of technology and operations management.

Art Center President Richard Koshalek believes design schools can help business schools in teaching a new generation of managers about innovation. "The business community is just now discovering the

importance of creativity," he says.

B-school students usually learn how to create business plans but only occasionally develop actual products or services. This process is integral to the Insead program. In January, eight Art Center College students flew to France to join 44 Insead MBAs. They were divided into eight project teams, each with a design student. For the first part of the program, the teams had to develop a new product idea. To help them, Insead set up their own design studio, with space for 3D rapid prototyping and brainstorming. MBAs who had worked in banking, insurance, and energy and were used to analyzing numbers were taught to focus on consumer needs, visualize ideas via prototypes, and test their concepts. "It doesn't feel like you're in a business school at all there," says Sosa.

By the end of 14 weeks, the teams completed their concepts—high-end luggage for professional women business travelers

with special compartments and wheels that make it easier to pull; running shoes that indicate when the shock absorbers are wearing down; a device that removes cigarette smoke from suits for nonsmoking American execs who must do deals in Paris or Frankfurt. "Working with design students has opened our minds," says Christine Hutcheson, a 34-year-old Insead MBA who

has worked at Sun Microsystems Inc. Her team developed the Contigo, an upscale "lunch box" for professionals that high-end grocers or Weight Watchers would fill with healthy food. "If you had just put five MBAs in a room with this project, they would have taken a three-ring binder, put it in a Ziploc bag, and punched holes in it," she says. "It's very hard to teach creativity, especially at a business school. I've loved this experience."

The second part of the program has the MBA students returning to the business world. The teams will soon present their concepts to actual angel investors who may take them into the marketplace.

As the final fillip to the program, in early May many of the Insead MBAs will travel to Pasadena. The Art Center College will take them to the BMW design studio, Nokia, idealab, and Walt Disney Imagineering in Los Angeles to see the role of design in business. Its faculty will teach courses in design and design management. The program will end with corporations sending recruiting reps to talk with the students.

Teaching elephants to dance may be easier than teaching managers how to innovate. Nevertheless, executives increasingly demand that their managers be creative. U.S. business and engineering schools increasingly offer product design and development courses. But Insead and the Art Center College appear to be taking it to a new level. Managing organizations is important. But managing creativity is the must-have skill for today's managers.

—By Bruce Nussbaum in New York and Rachel Tiplady in Paris



AN AMERICAN IN PARIS Design management at Insead

INSURANCE

AIG: GET READY FOR STARR WARS

The fight over a secretive entity that wields enormous influence over AIG is just starting

THERE'S PROBABLY NEVER been anything like this in U.S. corporate history: a titanic legal struggle pitting the interests of corporate governance and public shareholders against those of a private company and the rights of its owners. At the pinnacle of his power, Maurice "Hank" Greenberg didn't just control American International Group Inc., the insurance and financial services giant. He also sat atop Starr International Co. (SICO), the tightly controlled private company that, in a complex link to AIG, doled out compensation to top AIG execs. It controls 12% of AIG shares, worth some \$17 billion.

Now, as the Securities & Exchange Commission and New York Attorney General Eliot Spitzer probe deeper into AIG's accounting practices, a bizarre power struggle is emerging. Spitzer wants broad access to the records of SICO, arguing that its operations were so intertwined with those of AIG that they were all but indistinguishable. And although Greenberg moved to negotiate some access to disputed SICO documents on Apr. 6, according to a source close to the company, an intense fight could still loom over investigators' jurisdiction—and, ultimately, over control of the assets in SICO. Spitzer is marching into battle under the banner of protecting public shareholders; Greenberg is likely to defend his interests on the grounds that SICO is a private company.

LATE NIGHT HOUSECLEANING

GREENBERG, WHO was forced out of AIG as CEO and chairman on Mar. 14 and Mar. 28, respectively, set the stage for a showdown with regulators on Mar. 25 when his lawyers removed 80 boxes of SICO documents in the middle of the night from Bermuda offices shared by AIG and SICO.

Greenberg's lawyer, David Boies, later defended the move as an attempt to "protect" the documents from destruction. But the housecleaning prompted a furious Spitzer to threaten AIG with obstruction of justice charges—a threat Greenberg's resignation as chairman and a pledge of company cooperation have stopped for now. Yet days later, Greenberg led a move to oust current AIG executives from the SICO board without notifying regulators, further enraging Spitzer. "I guess he figures, 'What do I have left at this point? I'm going to fight,'" a source close to the probe says of Greenberg.

Overnight what had functioned as a sort of public-private hybrid was now

openly split. Already chairman of SICO, Greenberg appears to be trying to consolidate his control over the privately held entity. On the other side, AIG's board is striving to modernize and transform the insurer into an upstanding member of its industry. One source close to the company says the AIG board will challenge any efforts by Greenberg to walk away with control of SICO assets. Ultimately board members believe the

arrangement between SICO and AIG was designed to benefit AIG over the long term, not a select group of owners. Boies did not return repeated calls for comment.

As the dust settles, a legal minefield is coming into view. Here's a look at the wrangling ahead:

Though Greenberg is now negotiating with investigators and AIG over access to the 80 boxes under dispute, questions still remain. The most pressing: How much jurisdiction does Spitzer's office or the SEC have over privately held SICO? A source in Spitzer's office argues that under the state's tough securities law, "we have to prove that they were doing business in New York and that their actions could represent fraud." Spitzer could up the ante by again threatening obstruction of justice charges or targeting AIG's senior man-

SICO & AIG: Ties That Bind

Private company SICO controls a big chunk of the wealth of many top AIG execs. Below, pay grants some high-level execs received in a single year (2002).

AIG EXECUTIVE	PERCENTAGE OWNED OF SICO VOTING STOCK	CURRENT VALUE OF 2002 SICO PAY GRANT **
Hank Greenberg, Former Chmn. & CEO	8.33%	\$6.8 million
John A. Graf Exec. V-P	0	0.8
Donald P. Kanak Exec. V-Chmn & COO	0	2.5
Rodney O. Martin Jr. Exec. V-P	0	2.5
Howard I. Smith Former CFO	8.33	*
Martin J. Sullivan Pres. & CEO	0	3.4
Edmund S.W. Tse Senior V-Chmn.	8.33	*
All directors and execs of AIG (38 individuals)	41.67	

* Not disclosed ** Latest year available as of 4/6/05. Some or all of this may be revoked if executives leave AIG before age 65
Data: Company filings



GREENBERG
He still heads
Starr International,
which doled out
compensation to
top AIG execs

INVESTIGATIONS

WARREN AND HANK ARE SET FOR A GRILLING

When Buffett and Greenberg meet with Spitzer and the feds, old feuds may flare

WARREN E. BUFFETT and Maurice "Hank" Greenberg have styles as different as an elephant and a lion. Buffett is known

for his down-home, revival-style shareholder meetings and folksy musings. The imperious Greenberg is far more secretive yet blunt. Now, with probes into a questionable reinsurance deal between Greenberg's American International Group Inc. and Buffett's General Re Corp. insurance subsidiary moving into high gear, those differences are coming into full view.

On Apr. 11 and Apr. 12, Buffett and Greenberg, respectively, are scheduled to appear for interviews with investigators from New York Attorney General Eliot Spitzer's office, the Securities & Exchange Commission, and the Justice Dept. People close to the investigation say Buffett, who feuded with Greenberg years ago, has cooperated fully with regulators over the past weeks. "Some Buffett execs say he dislikes Greenberg from the old days," says one source. "Buffett's only too happy to let us know precisely how reinsurance can be used both properly and improperly." Buffett did not return a phone call seeking comment. Others contend that Buffett and Greenberg, though competitive, have long had a healthy respect for one another. David Schiff, who edits *Schiff's Insurance Observer* and has

written copiously about both AIG and Berkshire Hathaway Inc., the parent of General Re, says it's likely that Buffett is cooperating with regulators to protect his own company and reputation. "It's not personal," he says.

Still, it's not as if the pair have always had smooth relations. People who know both men say their sometime-animosity stems from one of Buffett's famous annual letters to his investors—this one circa 1985—in which Buffett indirectly criticized

AIG's use of reinsurance. He labeled a certain AIG practice "the lay-it-off-at-a-profit game." Greenberg was furious and retorted to *Barron's* at the time: "Buffett may be a good investor, but he's no insurance man. He has a peanut-sized book of business and only writes business in good times. He has never innovated one new product." The two

eventually patched things up and came to work together in the poker-like spheres of high finance for years. In 1998 they attempted to join forces to buy out fallen hedge fund Long-Term Capital Management together. Still, the two continued to duke it out in the insurance arena. In 2002, *Schiff's* compared Berkshire Hathaway's transparency to AIG's murkier finances and ran a cartoon of Greenberg and Buffett arm-wrestling over their companies' might.

Insurance experts are wondering if the rendezvous with regulators will turn into a showdown between the two icons. Buffett is bringing his in-house lawyer to the interview, says a source close to the investigation. Greenberg, by contrast,



BUFFETT
He criticized
AIG practices
back in 1985

agement, some of whom also served as CO directors.

Will the strategy work? Most legal experts believe Spitzer can claim oversight, because of the many links between the companies and because SICO is a New York presence. But former federal prosecutor Philip H. Hilder, for one, argues that jurisdiction is open to debate. Says Hilder: "The company is going to claim there's an independent relationship and hide behind that."

As the tangle of interlocking companies gets sorted out, the stakes are enormous for Greenberg. Retaining control of SICO would give him incredible power. He could influence decisions simply by threatening to sell AIG shares to get an ally appointed to the board. But like the board, some AIG shareholders are irked that Greenberg might walk away with control of the 12% AIG stake. Says one institutional investor: "It doesn't seem right that it would revert to Greenberg and the privileged few." Ultimately, resolution of the dispute will depend on unwinding the complex, decades-old document trail linking SICO to AIG.

If Greenberg continues to play it tough, his strategy could backfire. At the moment, nobody is quite sure how the drama surrounding SICO will unfold. As Greenberg contemplates his next move, it's clear that the 79-year-old insurance titan isn't going away anytime soon. Just as troubling for Greenberg, neither is Eliot Spitzer. ■

—By Diane Brady and Nanette Byrnes,
with Marcia Vickers in New York

has hired outside legal counsel—prominent attorney David Boies—to represent him. Buffett has “volunteered” to appear before regulators, according to his company. As for Greenberg, some are wondering if he’ll exercise his Fifth Amendment rights. Even so, “we’re preparing as though he’s coming in,” says a source close to the investigation. “Boies has been

saying in recent days that Hank has nothing to hide.” It’s possible that Greenberg, a famously hands-on manager intimately involved in the most minute details at AIG, could be criminally charged for his actions at AIG, says a source involved in the probe. Boies did not return a phone call seeking comment.

By contrast, Buffett—widely known as

a hands-off manager who was seeming unaware of the particulars surrounding the General Re/AIG transactions—is likely to be off the hook, says the same source. “You don’t know who’s swimming naked until the tide goes out,” Buffett once mused. In the tête à tête with Spitzer Co., who knows what will be revealed?

—By Marcia Vickers in New York

FOREIGN MARKETS

AIG Needs A New Tiger in Asia

Few chief executives could match the string-pulling prowess that ousted American International Group Chairman Maurice R. “Hank” Greenberg enjoyed in Asia. Sure, the company that would become AIG gained certain entitlements because it was founded in Shanghai in 1919, and was insurer to the U.S. military in occupied Japan. But it was Greenberg’s tireless networking with Tokyo bigwigs, lobbying crusades to gain China’s entry into the World Trade Organization and retrieve stolen cultural artifacts, and dealmaking instincts over several decades that turned AIG into a power in Asia. It is now the top foreign insurer in both China and Japan, a market leader in Southeast Asia, and an important new player in India. “Hank was a dominant force for AIG’s presence in Asia,” says Farrokh Kavarana, chairman of two AIG-Tata life insurance joint ventures in India.

Asia is critical to the performance of the financial-services behemoth, which is known in the region as American International Assurance, or AIA. Greenberg cited growth in AIA’s Asian underwriting business as a big driver of the 11% jump in the company’s \$3 billion fourth-quarter net income. And the region kicks in roughly 30%, or about \$30 billion, of the insurance giant’s \$99 billion in revenues. Operating profit margins for all foreign life insurance operations have been stellar, jumping from 11.7% in 1996 to 17.6% in 2003. Indeed, AIG’s Asian performance has been so stupendous that Deutsche Bank Securities analyst Alain



SHANGHAI Greenberg built AIG in China

Karaoglan thinks AIG needs to prove the numbers are real in light of the U.S. company’s admitted accounting shenanigans. “We are all in the dark now,” he says. “There will be more doubts going forward.”

Without Hank Greenberg greasing the wheels, can AIG keep it up? It won’t be easy. Working those Asia connections now falls to new CEO Martin J. Sullivan. He has some experienced Asian hands on his bench, such as Senior Vice-Chairman Edmund S. W. Tse, who oversees global life insurance operations from New York and used to run them in Asia. Executive Vice-Chairman and Chief Operating Officer Donald

P. Kanak, 52, is another. A fluent Japanese speaker who ran AIG’s operations in Japan and Korea for much of the last decade, Kanak negotiated the purchase of Japan’s failed Chiyoda Mutual Life Insurance in 2001 and General Electric Co.’s Japanese life insurance business, GE Edison, two years later. But whatever clout the two might wield, analysts say that Greenberg’s special status in Asia will be sorely missed.

What happens in Japan is crucial, since it is AIG’s biggest foreign market. Will Japanese regulators, who last fall forced Citigroup to shut down its private banking operations for engaging in unauthorized transactions, now take a close look at AIG’s books? There is no indication yet that they will—or have any reason to. But if the company were to get in trouble in Japan, it has a lot to lose. Last year AIG saw a 31% jump in life, health, and group insurance policies in its Japan operations.

In China’s more relaxed regulatory environment, AIG can rest easier. Most policyholders in China are in the dark about the uproar stateside. Good thing: AIG grabbed 57% of the insurance premiums generated by foreign insurers in 2004, and owns 10% of giant PICC Property & Casualty Co., which distributes its accident and health insurance products. Still, AIG will miss Greenberg’s heft in Beijing, where *guanxi*, or personal connections, reign. Because of the insurance company’s long history in China, back in 2001 Greenberg cinched a sweetheart deal as the only foreign insurer allowed to operate wholly owned subsidiaries in mainland markets.

Rival foreign insurers screamed, and the loophole closed in December. “The period of giving special treatment to AIG has already ended with China’s entry into the WTO,” says Tuo Guozhu, deputy director of the Financial & Business School at Capital University of Economics and Business in Beijing. Another era has ended, too. AIG is no longer run by the man whose forceful salesmanship and charisma pried open so many Asian doors. That will be tough to replace.

—By Brian Bremner in Tokyo, with Dexter Roberts in Beijing, Diane Brady in New York, and Manjeet Kripalani in Bombay

THE STAT

**\$30
BILLION**

AIG’s Asian revenues—30% of its total*

*Estimated Data: American International Group

BY EMILY THORNTON

Can Phil Purcell Change His Spots?

Morgan Stanley's CEO needs to be more hands-on. But don't count on it

PHIL PURCELL, please, please, do something about your aloof management style. That's the message that shareholders and investment bankers have been blasting for weeks. They want the Morgan Stanley CEO to go with bankers on their client calls, walk the trading floors, woo shareholders—and hang out with Masters of the Universe in New York on Saturday nights instead of scuttling home to Chicago.

You might think Purcell would make an effort to change his spots after all the recent commotion about him and his firm. But you'd probably be wrong. Although he has caved in to criticism from investors and employees by announcing plans to spin off the Discover credit-card business, which he built from scratch, there is little sign he intends to change the way he runs Morgan Stanley. His supporters say that's because he doesn't need to.

Although detractors say Morgan Stanley has lagged peers recently, the company claims it has delivered a 258% return to its shareholders since he took charge in 1997, vs. a 167% return for the Standard & Poor's Diversified Financials Index. Moreover, the investment bank says it is gaining market share in everything from mergers to stock offerings. Even in the throes of a bitter war of words, it managed to advise Unocal on its \$18 billion sale to ChevronTexaco—one of the biggest deals so far this year. The company credits Purcell with landing four major initial public offerings last year and spending half his time with clients. "If you call Phil and say, 'Can you do this?' he says 'Yes,' and it gets done," says William B. Smith, who worked with Purcell for 18 years and is one of five advisory directors who recently sent a letter to the board defending him.

Although the firm's investment bankers may now be screaming for more of Purcell's attention, Smith adds that in the past "[they] were not overly solicitous in asking him to get deeply involved in their businesses."

Through a spokesman, Purcell declined to comment.

Moreover, Purcell's two new co-presidents remain perfectly comfortable with his choice to be a strategy-setting arbiter. "He is not going to be a micromanager," says Stephen S. Crawford. Echoes Zoe Cruz: "He is going to let us run with the ball."

Maybe so. But if nothing changes, he will find it hard to win over temperamental investment bankers who are highly disillusioned in the wake of his most recent management shakeup. These bankers feel that Purcell is far too aloof and not involved enough in winning business. The investment bank accounts for nearly two-thirds of operating profits, and if these bankers bolt, those profits could take a major hit. And that could hamper Purcell's efforts to placate critics because he needs the bankers' support more than ever to make his vision of building a world-class integrated securities firm work.

How can someone so smart be so, well, stubborn? Although Purcell's style rubs some investment bankers the wrong way, a person close to the firm says his standing is better with the retail brokerage and asset management divisions. The main reason he won't change is because the board won't twist his arm. Directors dismiss serious complaints about his management style as none of their business. According to a source close to the board, the directors concluded that complaints about Purcell had little merit because they found no specific errors of judgment. And they believe it is not their place to tell Purcell how to conduct himself. But in investment banking, where building personal relationships is essential, style can matter almost as much as substance.

There is room for Purcell to change minds. For a few hours on Apr. 4, when rumors of a possible takeover by London-headquartered HSBC flew around, some critical bankers sided with him because they feared their salaries would nosedive if they had to work for a retail bank. Briefly, Purcell looked like the lesser of two evils. But another attack on Purcell by the Group of Eight former Morgan Stanley top guns quickly triggered a new round of grousing by bankers.

Purcell may have another chance to redeem himself. He says he wants the Discover spin-off to usher in a new chapter of the firm's history. If he's going to achieve that fully, he'll have to turn over a new leaf himself. ■

—With Stanley Reed in London

PURCELL The Discover deal may usher in a new era



ENERGY

OIL PRICES: DON'T COUNT ON A DIP

Despite bigger stockpiles, traders see tight supplies—even if OPEC ramps up

IS OIL READY TO TUMBLE? YOU would certainly think so judging from government reports on inventories. The Energy Dept. announced on Apr. 6 that U.S. commercial stockpiles of crude oil rose for the eighth straight week, hitting 317.1 million bbl., 8% more than a year ago and above average for this time of year, when refiners are gearing up for the summer driving season. Growing inventories usually signal that supply is exceeding demand—the prime condition for a price fall. For weeks, forecasters have cited the growth in inventories to argue that oil prices are bound to decline. On Apr. 5, Federal Reserve Chairman Alan Greenspan said in a speech that the growth in buffer stocks of oil, if sustained, could “damp the current price frenzy.”

So far, though, the frenzy is pretty much unabated. Oil prices fell just 19 cents on the inventory news, settling at \$55.85 a barrel for May delivery on the New York Mercantile Exchange. Oil has soared around \$12 a barrel since the start of the year. And gasoline prices are ratcheting up in tandem: They hit a record national average of nearly \$2.22 a gallon for regular as of Apr. 4, up 36¢ since the year began, according to the Energy Dept.

Why are prices so high when crude inventories are above average? Because traders are looking past the inventory numbers to the potential for trouble ahead. With spare global production capacity so short, today's inventory levels provide much less insurance against a spike in oil prices than they would in quieter times. “If you're using history as a guide here,” says Tina J. Vital, an oil-company equity analyst at Standard & Poor's, “you're go-

ing to get the wrong answer.”

Inventories are intended to carry oil companies over brief dips in supply and blips in demand for their product. But the risk now is for more than dips and blips. If world economic growth remains strong and producers can't add to their production capacity quickly enough, worldwide demand might exceed all-out production capacity. That would quickly exhaust inventories, and prices would soar until the cost of oil dampened demand. In a Mar. 30 report, Goldman, Sachs & Co. predicted that oil prices would average \$50 to \$60 a barrel this year and next. But it warned that if strong consumption growth collides with inflexible supply, a “super spike” could carry oil prices as high as \$105 a barrel. Reflecting a bit of that fear, oil for delivery in December 2005 settled at \$58.10 on the Nymex on Apr. 6—even higher than the May price.

DAUNTING DEMAND

FOR NOW, THERE'S still some slack in the system despite strong growth in demand from the U.S. and China. The In-

L.A. STATION The average U.S. gas price hit a record in early April

ternational Energy Agency estimated last month that oil stockpiles in the industrialized nations in the first quarter amounted to 51 days of con-

sumption, which is considered adequate. But the agency is predicting worldwide demand of 86.1 million bbl. a day in the fourth quarter of 2005, up 1.9% from the end of 2004. Based on its forecast for non-OPEC production, the agency says the “call” on OPEC to plug the gap and meet total demand would be 29.5 million bbl. a day in the fourth quarter. But meeting that target won't be easy for OPEC. Platts, an energy information service, calculates that the most oil OPEC has ever produced is 30.3 million bbl. a day, which it did last October. So OPEC would have to produce almost as much as it ever has in a single month, and do so for an extended period. Possible? Yes. But hardly a sure thing. “We're at a level of spare capacity where no matter what the inventory level was, the market would still be nervous,” says Rick Mueller, a senior analyst at Energy Security Analysis Inc. in Wakefield, Mass.

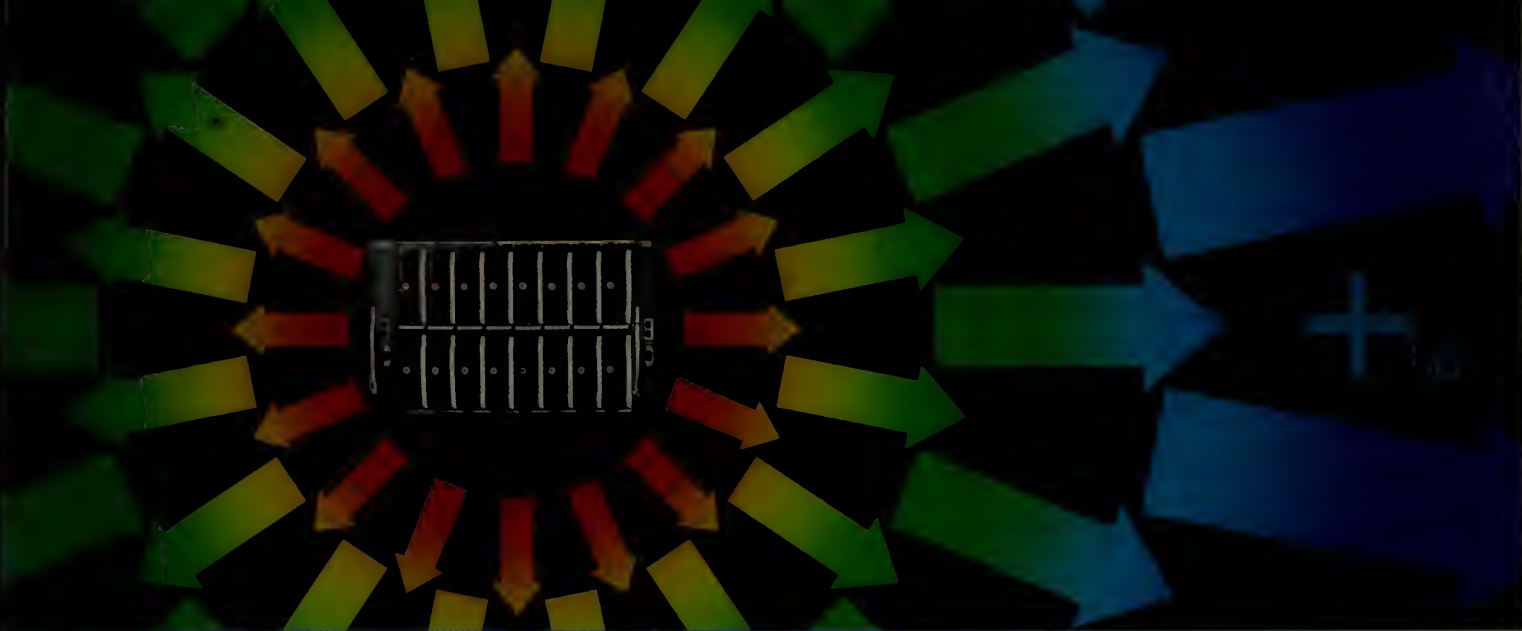
Inventories could suddenly matter again if the projected demand doesn't materialize this year. In that case, inventories might accumulate so quickly that oil companies would run out of room and have to put the stuff on sale. For now, though, people who put their faith in inventory levels to push prices down are being sorely disappointed. ■

—By Peter Coy in New York

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HOME BUYING

REAL ESTATE'S TURF WAR HEATS UP

How old-line agents are undermining advances by online discount brokers

FOR YEARS A BATTLE HAS been looming between traditional real estate brokers and Internet-based insurgents who are threatening to turn the market inside out. Now, as the Internet companies gain clout and the fight heats up, the battle lines are becoming clear. In one camp, the traditional real estate companies and the industry-friendly state commissions that regulate them. In the other, the Internet upstarts and Washington. On Mar. 31, the Justice Dept. filed a complaint against the Kentucky Real Estate Commission, arguing that local rules prohibiting brokers from giving consumers rebates on real estate commissions violate antitrust laws.

The Kentucky suit could be just the opening salvo from Justice. Given that eight to 10 other states have similar rules, many in the industry expect Justice to file comparable suits around the country. That could give a huge boost to the Internet camp. Such rebates are a key strategy for brokers like ZipRealty Inc. that do most of their marketing online. Similar gimmicks are also used by broker-referral services such as RealEstate.com, a unit of IAC/InterActiveCorp, which give consumers gift cards in lieu of cash rebates.

Clearly the old-line industry is worried. Realtor associations around the country are backing so called "minimum service"



laws like the proposed rules in Texas that could soon be passed by the state legislature. The Realtors argue that letting online brokers sell a stripped-down service, without performing such hard-nosed tasks as negotiating prices, would leave unwary consumers in the lurch. "These rules were put there for consumer protection by the legislature," says Austin lobbyist Bill Miller, who represents the Texas Association of Realtors.

VAST SAVINGS

BUT THOSE RULES have also turned the buying and selling of houses into a money machine for real estate brokers. Com-

missions to sell homes top \$60 billion a year. The industry is dominated by local brokers who buy franchises from national giants Cendant Corp. (which runs Century 21 and Coldwell Banker) and RE/MAX International Inc., as well as large regional independents. Most charge a commission of 5% to 6% of the purchase price for their services. By contrast, the online discounters offer huge savings. New York-area discounter Foxtons North America Inc. charges only a 3% commission. ZipRealty charges 5% to 6% but gives "rebates" of 25% of the commission to sellers. Some brokers with more limited services charge far less.

In exchange for cheaper commissions or other bennies, Web players expect consumers to do more of their own work or pay additional fees for more service. That can include arranging open houses and shelling out big bucks for escrow and legal fees. Many consumers seem to think that's fine: Foxtons expects to have upped its fee to 5% of the suburban New York market this year, CEO Van Davis says. ZipRealty, which went public in 2004, says it will earn as much as \$10 million this year on more than \$100 million in revenue, even though it has yet to reach 1% market share in any market where it does business.

The online brokers can afford to give big breaks since each house sale requires far less work. That means they can handle more clients at a time than traditional brokers. ZipRealty says its agents sell about twice as many homes as its rivals'. It cut costs by having few offices and finding clients via telemarketing or online advertising, rather than by having reps in every suburb.

Whatever their strengths, however, online brokers continue to be held back by the raft of industry-backed state regulations that blocks discounts on commissions. But as the Justice Dept. has shown in Kentucky, those regs could soon come tumbling down. ■

—By Timothy J. Mullaney in New York

What You're Paying for

Online brokers can cost less than traditional Realtors, but their level of service can be lower, too



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Sellers get a 25% rebate on Zip's portion of the standard 5% to 6% commission.

Zip has only one office in most cities. That can result in too few agents.

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COMMENTARY

BY LORRAINE WOELLERT

The Asbestos Mess: There Is a Way Out

Congress first should limit the right to sue to those who are already sick

WHEN A DOZEN LARGE business insurers on Apr. 4 took a shot at Congress' plans for a trust fund to compensate asbestos victims, lawmakers and business groups scrambled to insist that a deal could still be struck. The National Association of Manufacturers declared that it was still squarely behind the long-stalled proposal, and Senate Majority Leader Bill Frist (R-Tenn.) expressed optimism that legislation could pass this year. "I am confident we will have a bill, that centers on a trust fund, on the floor of the Senate in the not-too-distant future," Frist told reporters.

That's the spin. The reality: The insurers' rejection was just the latest nail in a coffin that was hammered shut months ago. Business infighting, overreaching on all sides, and the Bush Administration's lack of leadership killed any chance for the trust fund. Now, business has little chance of winning a deal that in one swoop would settle billions of dollars in asbestos claims and put an end to a litigation free-for-all that has bankrupted more than 60 companies. To pull itself out of the morass, Corporate America must instead regroup around a simpler fix that could eliminate 90% of pending cases.

The trust fund looked like a good idea in 2002. Confident that President George W. Bush's tort-reform drive would coast through a GOP-led Congress, asbestos defendants—industrial companies, insurers, and retailers sued because they sold asbestos-laced products such as brake pads or shingles—pressed for an overarching solution that would take some 300,000 lawsuits out of state courts. Under their plan, a business-financed fund would award claimants a fixed payment based on how sick they are. The fund, Corporate America figured, would cap its liability.

But the trust fund is collapsing under the weight of its complexity. A global settlement requires agreement in advance on minute details—how much an out-of-breath smoker who was exposed to asbestos should collect compared with, say, a life-long asbestos worker dying of lung cancer. After 2½ years of negotiations, insurers, manufacturers, and labor groups still are squabbling over basics such as who should pay what into the fund and what happens if it runs dry. Meanwhile, the fund's



This new tack could eliminate 90% of the pending cases

projected price tag has soared to \$14 billion. With Corporate America river the White House never put any muscle into asbestos, ranking it poor No. 3 on its list of legal priorities.

Now, negotiators should rally around another idea: the "medical criteria" approach. It leaves asbestos cases to the courts, but gives the sickest victims top priority. Congress would instruct judges to consider claims only from victims who exhibit specific

symptoms of asbestos-related disease. The rest would be put on hold, retaining the right to sue later should they get sick. Advocates say medical criteria could do away with some 90% of pending claims—including many filed by opportunistic lawyers hoping to land quick, easy settlements.

The medical-criteria fix is gaining ground in the states. Ohio passed legislation last year. Georgia Governor Sonny Perdue, a Republican, is expected to sign a similar bill this month, and bills are moving in Texas and Florida.

In Washington, the medical-criteria concept has long enjoyed backing from a large swath of the business community. But the most important support could come from the sickest asbestos victims and their lawyers, who fear that companies will be bankrupted before their claims are ever heard. These advocates have broken with other trial lawyers and labor to create a vital opening for compromise.

It's time for business and the GOP to accept that deal. With the Senate gearing up for an all-consuming battle over judicial nominations, Congress has no time to waste. If Bush wants to end the asbestos impasse, he'll have to put the weight of the White House behind the simpler yet effective approach. A medical-criteria bill—such as the measure Representative Chris Cannon (R-Utah) plans to reintroduce in the House—would give business and the courts much-needed relief while protecting the rights of real asbestos victims. ■



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EDITED BY MONICA GAGNIER

HEADLINER

**HANK
McKINNELL**



MAN WITH SCALPEL

Pfizer chief **Henry McKinnell Jr.** is performing radical surgery. On Apr. 5 the drug giant announced a restructuring aimed at cutting \$4 billion in costs by 2008, twice what many on Wall Street expected. "We do not underestimate the challenges we face," McKinnell told analysts in New York.

Pfizer's moves will crimp earnings in 2005. The company will take charges for its restructuring as well as a \$2.2 billion charge related to the repatriation of \$28 billion in foreign cash. Yet even without those one-time items, Pfizer expects 2005 net income to decline nearly 8%, to \$14.9 billion. But McKinnell vowed the cost-cutting will boost earnings by double digits in 2006.

Still, some on Wall Street aren't so sure. Sanford Bernstein analyst Richard Evans warns that Pfizer is counting on renewed strength in its \$4.6 billion Cox-2 painkiller franchise for next year's rebound, which he believes is unlikely. This is one patient that will resist a quick cure.

—Amy Barrett

REWRITING E-TRADE LAW

The **Securities & Exchange Commission**, in a 3-2 vote, approved on Apr. 6 a controversial overhaul of trading rules for all U.S. stock exchanges. The new rules require investors to get the best price when trades are executed electronically. The current rules bar "trading through"—ignoring the best price—only for issues listed on the New York Stock Exchange. The SEC vote was a blow to the **NASDAQ Stock Market**, which opposed extending best-price protection to its stocks. **Fidelity Investments**, some other institutions, and electronic-trading networks had pressed the SEC to scrap the "trade-through" rule altogether, arguing that investors should be able to trade where they like. The new rule, which was championed by SEC Chairman William Donaldson, will be phased in between Apr. 10 and June 12, 2006.

IN THE HOT SEAT AT AON



The nation's second-largest insurance broker, **Aon**, finally has a new CEO. On Apr. 4—nearly six months after company founder Patrick Ryan said he was stepping down—the board named

Gregory Case (pictured), the former head of the North American financial-services practice at **McKinsey**, to the top spot. Ryan will continue to serve as chairman. One reason it took so long to fill the corner office is Aon's regulatory run-ins. In March the company settled with several states over allegations that it took payment for directing clients to preferred insurers, charges it neither admitted nor denied. Case, 42, is relatively unknown in the insurance industry. But his consulting background may be a boon for the company, which needs to trim fat and improve the bottom line.

A TUNE-UP FOR GM

With his company in a crisis, **General Motors** Chairman and CEO Richard Wagoner Jr. is shaking up management. Wagoner has taken control of GM's North American business from Vice-Chairman Robert Lutz and manufacturing boss Gary Cowger, who was demoted to group vice-president for labor relations. Cowger will try to wrest concessions from the **United Auto Workers** to cut GM's \$5.6 billion annual health-care tab. Lutz, who keeps his title, will focus on developing new models worldwide. Analysts say Wagoner's reshuffling is likely to have little effect. He still has the same team trying to read the U.S. market.

SIRENS SOUND AT SIEBEL

Is trouble brewing in the software industry? That was the fear after **Siebel Systems** announced that it will post a first-quarter loss of up to \$9 million. That missed estimates by a mile, knocking

its stock down 10%, to \$8.2 on Apr. 6. License revenue for its customer management software came in the lowest in more than six years, which will mean a 9% drop in sale CEO J. Michael Lawrie cited problems closing deals and said tech spending remains soft. Analysts don't expect similar shortfalls from other software companies.

ET CETERA...

► **MCI** on Apr. 6 rejected **Qwest Communications International's** third offer to buy the company.

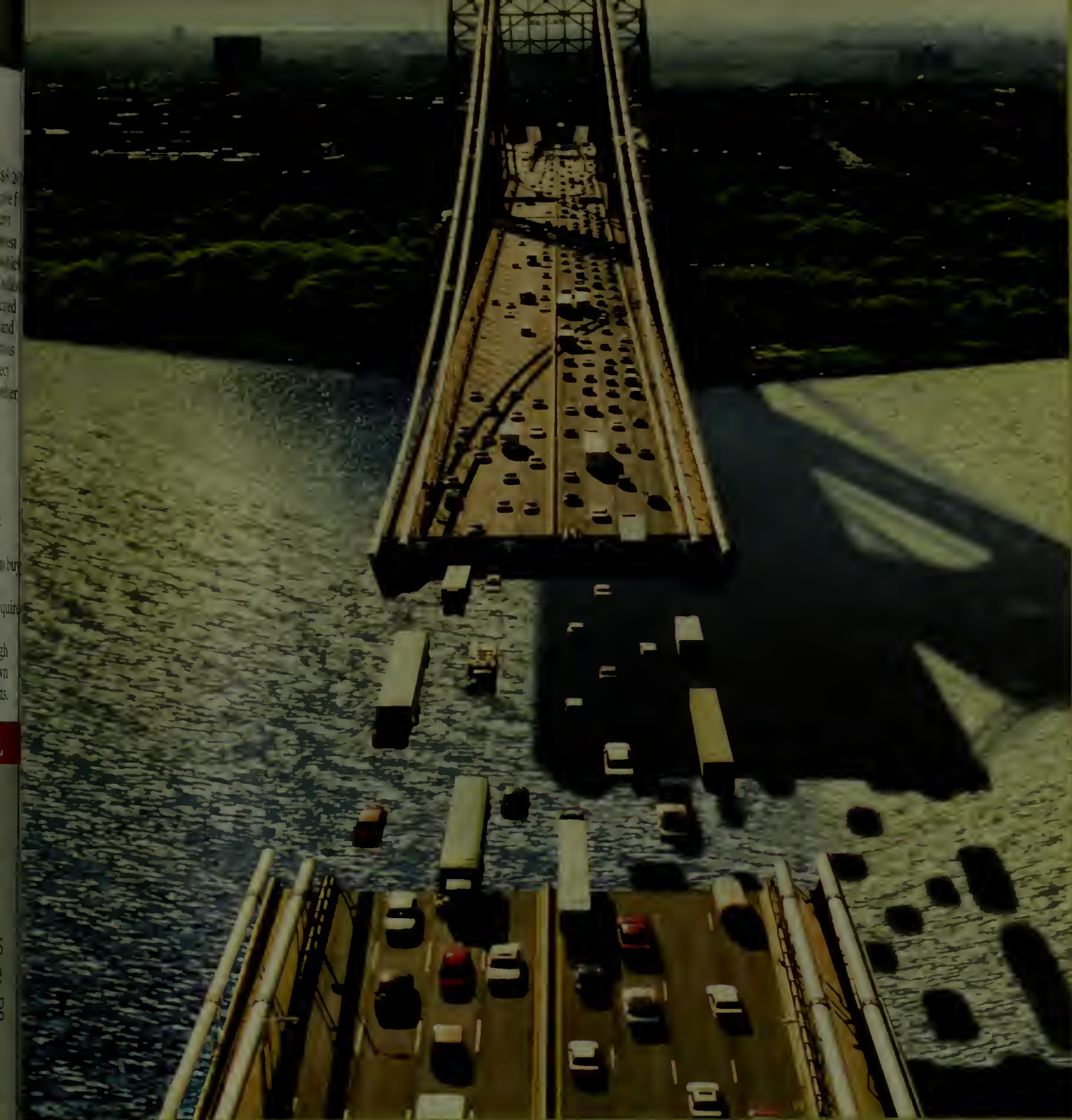
► **ChevronTexaco** will acquire **Unocal** for \$18.4 billion.

► Restructuring and high energy costs pushed down **Alcoa's** first-quarter profits.

CLOSING BELL

Shares of **Anheuser-Busch** fizzled 4%, to \$45.65, on Apr. 6 after the St. Louis brewer lowered its earnings estimate for 2005. The King of Beers, which faces increased competition, also said first-quarter domestic sales to wholesalers fell nearly 3%.





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EDITED BY RICHARD S. DUNHAM

Can the GOP Lure Blacks 'Home'?

WHEN IT COMES TO ATTRACTING African American supporters, Republicans realize that such an arduous journey begins with a few small steps. That's why on Mar. 31, Republican National Committee Chairman Kenneth B. Mehlman came calling at Howard University, an historically black school in the nation's capital.

His mission: to convince young African Americans they should join the party of Abraham Lincoln rather than that of their parents and grandparents. With just about 100 students, the audience for Mehlman's speech was barely larger than the group of protesters kept outside by burly campus security guards. But the GOP party boss was unfazed. "Give us a chance," he pleaded, "and we'll give you a choice."

Mehlman's visit to the political lion's den is part of a concerted effort by Republicans to soften the support of the modern Democratic Party's most loyal constituency by concentrating on independent-thinking college students and socially conservative church congregations. By incrementally increasing the GOP's share of the black vote over the next decade from the 11% President George W. Bush received in 2004, former RNC Chair Ed Gillespie says the eventual result could be "a seismic shift" in political control as 20% to 30% of blacks migrate to the GOP.

That's beyond optimistic, but even a modest gain could make a difference in traditional battleground states. "African Americans are in a period of self-reflection now, and it's no time to take them for granted politically," warns Donna Brazile, a Democratic strategist who was Al Gore's campaign manager in 2000, when he took 92% of the black vote. Among Brazile's worries: a concentration of 2006 Senate and gubernatorial races in states with higher-than-average black populations, including Florida, Maryland, Michigan, Mississippi, New York, Tennessee, and Virginia. Democrats must defend four of the seven Senate seats and

would love to take the seat likely to be given up by Senator Trent Lott (R-Miss.).

Ohio Strategy

THE GOP STRATEGY attempts to mirror the 2004 plan for Ohio in which Bush nearly doubled his vote among Buckeye blacks to 16%. Republicans will woo churchgoers who agree with Bush's "values" agenda—opposition to same-sex marriage and support for federal subsidies for "faith-based" charity work. They also hope to attract young, upwardly mobile African Americans by highlighting economic empowerment, individual choice in education and health care, and party stars such as Secretary of State Condoleezza Rice and Maryland Lieutenant Governor Michael S. Steele.



MEHLMAN is wooing blacks who share Bush's "values" agenda

Still, history shows Mehlman's efforts may be more ambitious than effective. Despite millions spent on ads in minority media outlets, Bush's 11% black vote last year was actually slightly below the post-1964 average of 12% for a Republican Presidential candidate. To do any better, says David Bositis, political analyst at the nonpartisan Joint Center for Political & Economic Studies, "Republicans will have to start supporting issues particularly of interest to African Americans, such as affirmative action and minority set-asides on government contracts."

Republicans are convinced that they have a winning formula. But it will take many more pilgrimages for Mehlman to disprove the doubters. "We can't call ourselves the majority party unless more African Americans come home," he declares. On that, both parties agree. ■

—By Paul Magnusson

CAPITAL WRAPUP

A WATCHDOG WHO KNOWS FANNIE'S TRICKS

FANNIE MAE and Freddie Mac may soon have a regulator with firsthand knowledge of some of their less savory business practices. Congress and the White House are pressing ahead with plans to scrap the Office of Federal Housing Enterprise Oversight and replace it with a more robust regulator. **Ronald Rosenfeld**, 55, former president of the Government National Mortgage Assn., is the leading candidate to head the new agency that will oversee the scandal-scarred housing giants. In 2004, when Rosenfeld was still at Ginnie Mae, a federal court ordered Fannie to pay \$6.5 million for allowing a lender to dump fraudulent loans on Ginnie. If appointed, Rosenfeld will fill the shoes of **Armando Falcon Jr.**, a Clinton Administration holdover who withstood strong political pressure as he uncovered billions of dollars in accounting shenanigans and forced out Fannie CEO Franklin D. Raines and Freddie CEO Leland C. Brendsel. Rosenfeld put in stints at Treasury and Housing & Urban Development.

PASSPORTS THAT SAY 'STEAL ME'

BUSINESS TRAVELERS are up in arms over the State Dept.'s proposal to require all U.S. passports to carry a radio frequency identification chip. **The Business Travel Coalition** warns that pickpockets and muggers could roam hotels and airports with card readers, identifying and targeting Americans. A passport can garner up to \$3,000 on the open market, the group says. "Carrying a U.S. passport would be akin to placing a sign on one's lapel advertising a \$3,000 giveaway," the coalition warns.

THE VATICAN

THE CHURCH'S CHALLENGES

From a priest shortage to shaky finances, the next Pope will be tested

POPE JOHN PAUL II WILL be a hard act to follow. For 26 years, he led the Catholic Church with personal charisma and uncompromising moral authority. He played a decisive role in the collapse of communism in Eastern Europe, did more than any other Pope to end centuries of anti-Semitism, and in his globe-girdling travels pleaded tirelessly for social justice. Under his pontificate the ranks of the world's Catholics increased 40%, to 1.1 billion, thanks to fast growth in Asia, Africa, and Latin America. As a monument to the power of one man to bear witness to the Gospel—and to share that witness with millions of others—his papacy was one of the greatest ever.

Yet John Paul has also bequeathed to his eventual successor an institution that, by several measures, badly needs reform. There are many problems, but four stand out: a critical shortage of priests; a financial crisis in many parts of the Church; a growing split between the Church of the affluent West and the impoverished South; and the institutional weakness of a Church that centralizes too much authority in the hands of a few.

These are challenges that would make even the most seasoned chief executive blanch. But Catholics around the world, from U.S. executives to Indian bishops to lay volunteers in Brazil, are brimming with ideas on tackling each crisis. Here is a detailed account of each challenge—and what can and cannot be done.

» **The priest shortage.** In the U.S. in the 1950s, there was one priest for every 650 parishioners. Now the ratio is one to

1,500, as many leave the priesthood and young men take other paths. The average age of U.S. priests is almost 60. It's roughly the same situation in Western Europe.

Yet while the number of priests is growing in parts of Africa, Latin America, and Asia—India has even sent clerics to the U.S. and Europe—in general they're not keeping pace with exploding Church membership in the developing world. "We are getting more vocations than elsewhere," says James B. Reuter, a Jesuit priest and spokesman for the Catholic Church in Manila, "[but] we don't have enough priests." In Latin America there are 7,000 Catholics per priest. "In remote areas, Latin Americans are lucky if they see a priest even once a year," says Mary L. Gautier, senior research associate at the Center for Applied Research in the Apostolate at Georgetown University. Other areas, like Africa, lack funds to build seminaries to train applicants.

This dearth strikes at the very heart of Catholicism, since only priests can perform the central act of the liturgy—turning bread and wine into the body and blood of Christ. The Reverend John P. Beal, professor of Canon law at Catholic University of America in Washington, D.C., spells out the consequences: "The fear is that as the Eucharist becomes less available, Catholicism will be transformed from a sacramental faith into more of a word-based faith." In other words, it will become more like its evangelical Protestant rivals. "That would change the essential character of being Catholic," adds Beal.

LYING IN STATE

John Paul II in Sala Clementina a day after his death





What to do? Liberal Catholics have an answer. The Church should allow priests to marry and widen the field of candidates. That could be done by the Vatican in a moment, since priestly celibacy is a tradition, not a doctrine. The Church has even allowed married Episcopal priests to convert and join the Catholic clergy.

Since John Paul brooked no discussion of celibacy, his successor would have to make a radical break to achieve change. Yet the pressure from the U.S. and Europe will continue to build. Dean R. Hoge, a sociology professor at Catholic University says a recent survey of U.S. Catholics found 71% support making celibacy optional for diocesan priests. If that happened, Hoge predicts the number of U.S. seminarians would quadruple.

At the same time, reformers argue that lay Catholics should be given more responsibility in the Church around the world. Though that's already happening, the laity still has little say in such issues as selecting parish priests and shaping budgets. Hiring more qualified lay people and giving them more responsibilities would free up priests to focus on religious duties. But that means raising money to pay lay workers a living wage. Which leads to the second problem:

»Church finances. Nobody knows exactly how much money the Church raises and spends worldwide. But a sexual abuse scandal in the U.S. has cost the Church at least \$700 million, bankrupted three dioceses, and dented collections from disillusioned parishioners. That hurts the U.S., and also hurts the Church in Africa, Latin America, and Asia, where many dioceses depend on money infusions from the West. Francis J. Butler, president of Foundations & Donors Interested in Catholic Activities Inc., an organization of major U.S. Catholic foundations, says the annual Mission Sunday collection raises \$200 million each year to support the Church in the Third World. Yet U.S. Catholics donate only 1.1% of their income to the Church, half the figure for Protestants. "The growth of Catholicism is exceeding the ability to pay for the priests and ministries that are needed," Butler says.

Church leaders in Asia and elsewhere are scrambling to fund their social programs. Bishop George Punnakottil of Kothamangalam in Kerala, India, has organized credit unions in each parish. "We

Should the Church focus its resources in emerging nations?

collect money from constituents and disperse it as loans to the needy," he says.

Ingenious, but that can only go so far. In countries like the Democratic Republic of the Congo, where the number of Catholics tripled during John Paul's papacy, local dioceses don't raise enough money to pay basic operating expenses, let alone dispense charity.

But how can affluent Catholics be persuaded to give more to support the Church around the world? The Leadership Roundtable, a group of 200 influential U.S. Catholics, led by Geoffrey Boisi, a former vice-chairman of JPMorgan Chase & Co., recommends that every diocese publish a certified annual budget and strategic plan, thus giving the faithful a far fuller accounting of how contributions are actually spent. Such transparency would allay suspicions of the laity about how the Church spends its money, and improve contributions. Peter G. Danis, an active Catholic and former chief executive of Boise Cascade Office Products Corp., even suggests that the Church split its management structure in two. Most administrative functions would be handed off to a separate organization run by professionals who would give a more public accounting than the Church now does. A sustained effort to improve finances and disclosure would also probably help Catholicism with its third challenge:

»The West-South split. The new Pope will have to carefully choose where to focus his limited resources. In Latin America and Africa, where Christianity is spreading fast, Catholicism faces a market share battle with evangelical Protestantism and Islam. Meanwhile, many Cardinals are deeply concerned over the increasing marginalization of the Church in Western Europe. Focusing on a revival of Catholicism there might be appealing, but it could have severe consequences. "The Catholic Church can afford to lose the Netherlands" and other Western European countries, says Philip Jenkins, a Penn State University history professor and author of the book *The Next Christendom: the Rise of Global Christianity*. "But it cannot afford to lose the Philippines or Latin America."

Yet that's a possibility. Look at what's happening in South America. Although total Church membership in the region continues to grow, the percentage of Latin Americans describing themselves as Catholic has slipped from more than 88%



in 1970 to about 85% today, as millions have defected to Protestant denominations. Protestant congregations often seem more welcoming. "They offer a closer relationship with parishioners, with less hierarchy, and that better meets the needs of contemporary men and women," says the Reverend Israel Batista, a Methodist minister who is general secretary of the Quito (Ecuador)-based Latin American Council of Churches, a Protestant organization. Evangelical outreach programs to help working-class men stop drinking, for example, can quickly have an enormous impact on a small community.

Latin America also is feeling the strains long evident in Europe and the U.S.: "The Church says one thing and the people say another," says Sister Irmã Lourdes, a philosophy teacher at Colégio São José in Santo André, outside São Paulo. While many Latin Americans embrace Catholic traditions such as religious holidays and prayer to the saints, they ignore Church teachings on birth control, divorce, and homosexuality. "If the Church wants to slow the migration of its faithful to other religions, it needs to tone

down the dogma of its doctrine," says Juan Luis Hernández, director of the political science department at Mexico City's Iberoamericana University, a Jesuit institution. Toning down the dogma might not be possible, but the Church could learn to be more responsive to local needs. That's part of the fourth challenge:

» **The rigid hierarchy.** Many lay Catholics—especially in the U.S. and Europe—feel the Vatican could do better in understanding what goes on at the parish level. John Paul concentrated ever more power in the Vatican, managing everything from the role of altar boys to the translation of liturgies into local languages.

This top-down arrangement is unwieldy for an organization that increasingly resembles a far-flung group of islands, each with its own different population and needs. It also fuels discontent among front-line clergy and lay people, and it muffles the warning signals of things going wrong in a distant diocese. "There are 3,300 bishops and cardinals," says Danis, the former Boise Cascade exec. "But they see [the Pope] every three to five years. There's no built-in accountability. That's how the sexual abuse scandal in the

SUDAN COMMUNION

Membership in the Church is exploding in Africa

U.S. festered for so long."

Some U.S. managers have suggestions to improve the information loop, and the ability of Church leaders to work with the rank and file.

John T. Ryan III, an active Catholic and CEO of Mine Safety Appliances in Pittsburgh, wants term limits in the Curia, the Vatican bureaucracy. "Once you go to Rome, you never leave," he says. "There needs to be a constant infusion of [diocesan clergy] into these jobs for limited amounts of time, three to five years." The Leadership Roundtable wants the Church to adopt the "best practices" of multinationals. Among them: advanced management programs for bishops and a big increase in the role of lay experts. These ideas are being considered by the U.S. bishops.

Is the College of Cardinals ready to name a Pope who would push through such far-reaching changes? Most of the current 117 cardinals who will choose the next Pope were named by John Paul and helped promote his policies. "Only a minority of them think he went too far in institutional rigidity," says one French theologian. Yet previous conclaves have often surprised the world with their choices.

The Vatican's supporters, meanwhile, point out that just as there was one Christ, there is one Pope, and one authority. "The Church is not a corporation," says Monsignor Klaus Kastel, a Dutch cleric who was close to John Paul II and who works at the Vatican. "Tradition has to be observed as much as possible. Christ organized his Church in a centralized way." Somehow, the new Pope must reconcile that tradition—and the astonishing legacy of John Paul II—with the need to go forward. ■

—By Carol Matlack in Paris and William C. Symonds in Boston, with Ann Therese Palmer in Chicago, Maureen Kline in Rome, Josey Puliyeenthuruthel in Bangalore, and Geri Smith in Mexico City

The State of The Catholic Church

AFRICA	ASIA	LATIN AMERICA	EUROPE	U.S. & CANADA
Membership: 147 million	Membership: 124 million	Membership: 483 million	Membership: 277 million	Membership: 80 million
Annual growth*: 3.4%	Annual growth: 2.6%	Annual growth: 1.9%	Annual growth: 0.2%	Annual growth: 0.95%
Members per priest: 5,000	Members per priest: 3,000	Members per priest: 7,000	Members per priest: 1,300	Members per priest: 1,500
Urgent problems: Lack of money for social welfare, ineffective response to AIDS epidemic	Urgent problems: Persecution of Chinese Catholics, tensions with fundamentalist groups	Urgent problems: Acute priest shortage, loss of members to evangelical denominations	Urgent problems: Church attendance and collections declining, few entering priesthood	Urgent problems: Financial crisis after sex abuse scandal, complaints over rigid hierarchy

*Growth figures are 1970-2005

Data: World Christian Database, Center for Applied Research in the Apostolate, Leadership Roundtable, BusinessWeek

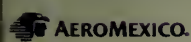


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BRITAIN

IF THE ECONOMY AIN'T BROKE...

Blair's strong record of fiscal stewardship may be his saving grace in the election

IN 1997, MARK JEFFERIES STARTED Camel Construction Products Ltd., a business that sells heavy curbstones to line the road of West Yorkshire. The company, which was formed when Tony Blair first became Prime Minister, has thrived under his Labour government. Revenue jumped nearly 40% in 2004. Jefferies, 39, who began with one assistant, now has five em-

ployees. His lead is down to an average of 1 percentage point in five recent polls. Robert M. Worcester, chairman of pollsters MORI says "a hung Parliament with Labour in the lead is possible," although he still thinks Blair is likely to gain an outright majority.

If Blair holds on and wins, it will be thanks to the economy, which has grown every quarter under his watch. "The Con-

servatives are not able to claim the economy has gone to the dogs," says Anthony King, professor of government at University of Essex. Labour has built on efforts begun under the Tories to curb inflation, notably by giving the Bank of England power to set interest rates.

BALANCING ACT

BLAIR AND HIS PARTNER, Chancellor of the Exchequer Gordon Brown, have had to juggle conflicting demands. Brown spent his first term cutting public spending from 40.6% of gross domestic product to 38% in fiscal 2001-02. But in the second term, public spending has climbed to a projected 42% for the current year. Brown wants health outlays to leap by 9.2% this year.

Instinctively, Blair favors slashing the welfare rolls further and selling off public housing. He also wants to tackle pension reform. If he manages to hold onto a 70- to 100-seat majority, he will be able to do what he wants. But if his lead is reduced to 40 seats or less, he may not prevail over Labour rebels and the left-leaning Brown.

Economic changes may well force change no matter which party wins. There are signs that the economy is slowing as higher rates and plateauing housing prices curb consumer spending. And public debt is about 35% of GDP, near the 40% limit that Brown holds sacrosanct. With a less robust economy, the next Prime Minister will realize that he can't continue to throw huge sums at public services. "Somewhere down the road the whole model of the welfare state is going to come up for grabs," says Derek Scott, Blair's economic adviser from 1997-2003.

Businesses already are raising red flags. Brown has loaded a big chunk of his tax increases on business, and companies are screaming about red tape. "Since 1997 more of my time has been spent on paperwork and regulations than on running the business," says Andy Willox, 61, who runs a contract cleaning company in Aberdeen. Willox has good reason to complain. But if he lived in one of Europe's stalled economies—Germany, say—he might not even be in business. ■

—By Stanley Reed, with Kerry Capell, in London

TAKING HIS LUMPS
Blair's popularity plummeted over Iraq



How Britain Has Changed Under Blair†

MEDIAN INCOME*	HOUSE PRICES
+17%	+176%
TAXES AS % OF GDP	UNEMPLOYMENT
+2.2 Percentage Points	-2.6 Percentage Points

†1997-2005 *Fiscal year ended March, 2004.
Data: Institute for Fiscal Studies,
HM Treasury Nationwide Building Society Office of
National Statistics

ployees. He remains a dyed-in-the-wool Tory, but admits the business climate has been better than expected. "Low interest rates are good for manufacturing and very welcome," he says.

Blair should give thanks for the robust economy. On Apr. 5 he asked Queen Elizabeth II to dissolve Parliament and schedule a general election for May 5. But Blair's popularity has been battered by his decision to take Britain into the war in Iraq. Many voters also say the Prime Minister is not trustworthy and that he has fallen short on promises to improve pub-

lic services. His lead is down to an average of 1 percentage point in five recent polls. Robert M. Worcester, chairman of pollsters MORI says "a hung Parliament with Labour in the lead is possible," although he still thinks Blair is likely to gain an outright majority.

Yet there are still profound differences between Blair and the Tories. Blair and his cohorts believe that government should be the major player in vital areas including health care and education. The Conservatives are skeptical of the public sector and want to trim it back. Although

NDIA

COPYCATS NO MORE

Indian pharma moves into pure research

GOREGAON IS A SUBURB of Bombay best known for its Bollywood studios. But there's more than moviemaking going on there. Just 100 yards off the Western Express Highway is the tree-lined road to a sprawling, red-and-gray, contemporary building. This is the new, \$20 million, 300,000-square-foot research and development center of Indian pharmaceutical company Nicholas Piramal India Ltd. The building is staffed with 250 young scientists earnestly poring over chemical formulations in pursuit of new treatments for diseases from cancer to malaria.

Looking for the next area of science and technology where India will challenge the West? Pharmaceuticals may be it. Nicholas Piramal—annual revenues, \$350 million—runs one of four pharma research centers that have sprung up in India in recent months. The country now has 50 such centers, and more will open this year. The reason: India's new patent protection law, which brings the nation in line with World Trade Organization norms. The law took effect in late March—and its passage means Indian



companies can no longer ignore the patents of multinational drug companies and produce unlicensed generics. What they hope to do instead is develop their own patented drugs. Thus the spate of new research facilities. "Indian companies are no longer going to be just copycats," says Dr. Swati A. Piramal, director of the Piramal center. "We want to take our rightful place at the head table with the developed nations."

Can India go from being a renegade drug producer to a competitor of the likes of Pfizer Inc. and GlaxoSmithKline PLC?

IN THE HUNT
Ranbaxy has poured \$200 million into R&D in 2004

Indian drug execs think it can. Experts say Indian pharma will grow from a \$9 billion industry today to \$25 billion by 2010. Piramal will have five to eight new patented drugs, including treatments for cancer and diabetes, ready for clinical trials by 2008. Other big players such as \$1.2 billion-in-revenue Ranbaxy Laboratories Ltd. and \$450 million Dr. Reddy's Laboratories Ltd. are also fast expanding into patented drugs.

AGGRESSIVE LAUNCH

INDIA'S TRANSITION from pariah to mainstream player will be difficult. The passage of the new patent law means multinationals will invade India in force. Merck & Co. and Bristol-Meyers Squibb Co., which left India years ago because they were unable to protect their patents, are returning. GSK plans to launch several antibiotic, cancer, and cardiovascular products in India this year. Novartis is planning to market its latest cancer drugs and immunosuppressants for kidney and liver transplants. "We will launch aggressively," promises Novartis India Ltd. Chairman Ranjit Shahani.

But India brings some formidable advantages to the fight. It already sells \$1.15 billion worth of drugs in the U.S. and Europe, all of them generics. India has 74 U.S.

Food & Drug Administration-approved pharmaceutical manufacturing facilities, more than any other country outside the U.S. As it begins producing patented medicines, it will benefit from low costs. The price of developing a drug from scratch in India is as low as \$100 million, vs. \$1 billion in the West.

And Indian companies that can't beat Big Pharma will join it. Several Indian drugmakers have already struck outsourcing deals with multinationals. Nicholas Piramal has \$500 million worth of contracts with Allergan, Advanced Medical Optics, and Novartis. "Indian companies are learning and earning," says Ajay Sharma, pharma analyst at brokerage CLSA Asia-Pacific Markets in Bombay. Once they have learned, the best of them will declare their independence. "In the future, we want to be a discovery-led company, an innovator company," says Satish Reddy, CEO of Dr. Reddy's Labs. A pharma juggernaut? Not yet. But India will definitely be a player. ■

—By Manjeet Kripalani in Bombay

Will India Be the New Drug Titan?

INDIA'S PHARMA BIZ IS GROWING FAST...

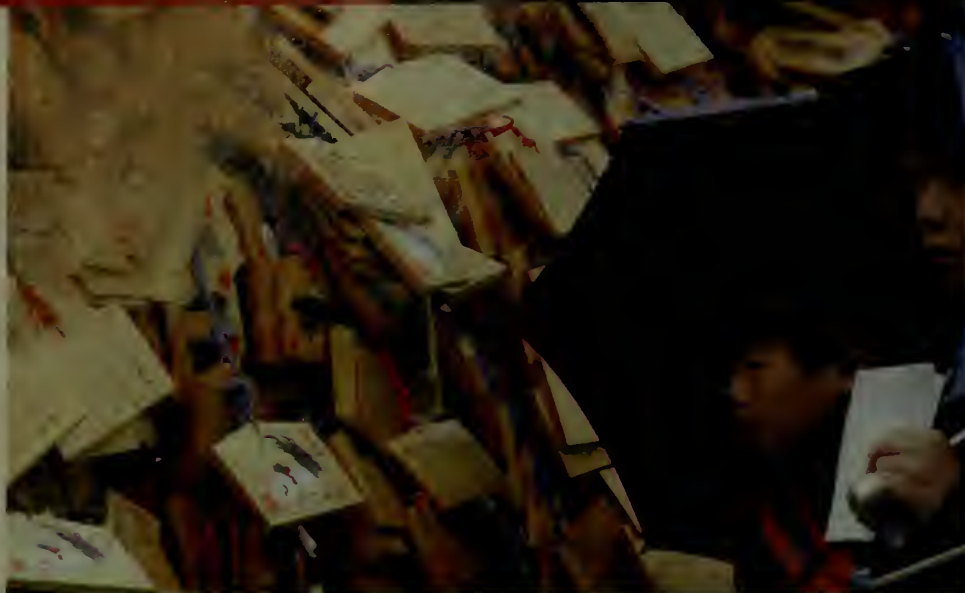
- It takes in \$9 billion a year and is expanding at 10% a year
- It has 4% of the global generics market, which could swell to 33% by 2007
- Some 50-70 new patented drugs are in development and could be on the market by 2010
- Outsourcing for multinationals will be a major new business



...BUT IT ALSO HAS GROWING PAINS

- The new patent bill means Indian pharma can no longer copy and sell patented drugs
- Spending on patent-busting lawsuits and higher investment in R&D will be a drag on profits
- Competition from multinationals could drive many small Indian firms out of business

Data: Global Insight, CLSA, YesBank



JAPAN

PARENTS GO CRAZY FOR CRAMMING

Tutoring outfits are thriving, and new global student rankings may fuel demand

IT'S NO SECRET THAT THE JAPANESE have long been obsessed with education. Students flock to shrines to leave prayers asking for good grades, and the lure of top schools is so strong that even kindergartners sometimes study for months before entrance exams. For years that obsession has paid off in global leadership in innovation and design for Japan.

These days, though, the country is losing its edge. In December, the Organization for Economic Cooperation & Development released a study of 15-year-olds from 41 countries showing that Japan ranks sixth in math and 14th in reading, down from first and eighth, respectively, in 2001. While it held steady at No. 2 in science—and remained well ahead of the U.S. in all three subjects—the figures were greeted with horror, fueling a debate over falling standards in schools and a slow disintegration of adult authority in the classroom and at home. A key concern is a government decision three years ago to ease the workload for elementary and junior high school children by 30%.

Those dark clouds for Japan, though, look like sunny skies to the operators of

juku, or “cram schools.” The country has some 50,000 of these outfits, which offer evening classes where students bone up on everything from chemistry to classics. The *juku* have been around for years, but demand for the services of the better schools is soaring as national anxiety about educational standards intensifies. Fifteen of the 21 publicly traded *juku* figure their earnings rose for the year ended in March. Eikoh Inc., Japan's largest listed *juku*, expects a 40% jump in profits, to \$18.9 million, on sales of \$345.1 million. At Shizuoka-based Shuei Yobiko Co., sales are

Downgrade

Ranking of Japanese 15-year-olds compared with students from 41 nations

MATH		READING	
2001	2003	2001	2003
1	6	8	14

Data: Organization for Economic Cooperation & Development

TOKYO SHRINE

Wood slabs carry prayers for entry to top schools

expected to jump 8.4%, to \$109.4 million, according to Mizuho Securities Co.

Because of the looser standards at public schools, parents are more willing to drop cash to give their children an edge. Japan's educational spending per household jumped 8.6% last year, according to Masatoshi Kikuchi, Merrill Lynch & Co.'s chief equity strategist in Japan—easily outstripping the country's 2.5% growth in gross domestic product. To many parents, the money is well spent considering the low esteem in which many Japanese now hold their schools. “Public education lacks a service mindset,” says Kikuchi, who lays out about \$500 per month on *juku* for each of his two children.

GROWING COMPETITION

CHANGES IN JAPAN'S social fabric are helping the *juku*, too. There's a growing class of wealthier parents willing to spend lavishly to give their kids an advantage in a society where lifetime employment, even for university grads, is fast becoming a memory. This drive for security has spurred a leap in applications to all private schools, from primary grades through college. For two years, 42-year-old Tomoko Yamamoto has been sending her son, Atsuki, to a *juku* that prepares students for entrance exams at elite junior high schools. Atsuki, 11, attends extra classes from 5 p.m. to 9 p.m. four days a week and takes tests every Sunday. The tab? Some \$9,200 this year. Like many Japanese parents, Yamamoto hopes the tutoring will help Atsuki get into a private junior high and, eventually, a top university. “At private schools, children have more opportunities to deepen their knowledge,” she says.

The *juku* face some potential problems. The biggest is Japan's falling birth rate, which means the schools are chasing a shrinking number of potential clients. And growing competition means the *juku* must boost advertising even as it gets harder to hike prices. Takeshi Watanabe, CEO of Shuei Yobiko, says a decade ago he raised tuition fees every year. “We can't do that anymore,” he says.

Still, even if the government toughens education standards again—something most Japanese would welcome—it's unlikely such a move would dampen enthusiasm for the *juku*. Japan's new insecurity over its age-old obsession, it seems, is good for business. ■

—By Ian Rowley and Hiroko Tashiro in Tokyo

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EDITED BY ROSE BRADY

Mexico: This Squeeze Play Could Backfire

IT'S 15 MONTHS UNTIL MEXICO'S July, 2006, presidential election, and the race is already shaping up as one of the most vicious ever. At the center of a growing political controversy is Mexico City's 51-year-old populist mayor, Andrés Manuel López Obrador of the left-leaning Party of the Democratic Revolution (PDR). He's

the front-runner, with a 13-point lead. But President Vicente Fox's National Action Party (PAN) and the Institutional Revolutionary Party (PRI) Fox defeated five years ago are mounting a legal challenge that could keep López Obrador out of the race.

The complicated legal saga dates back to a 2001 lawsuit over the city's construction of a hospital access road on disputed land in Mexico City. Although many Mexicans consider the disagreement minor, the PRI and the PAN are joining forces for a vote to strip López Obrador of the immunity from prosecution he enjoys as a public official. This vote on *desafuero*, as it's called, would allow the Fox administration to charge him with ignoring a court order to stop the road's construction. Under Mexican law, politicians cannot run for office if under indictment.

López Obrador calls the charges politically motivated and vows to run for President from jail if necessary. As *BusinessWeek* went to press on Apr. 6, the Mexican Congress, where the PRI and the PAN hold 75% of the seats, was preparing to vote on the mayor's immunity. His supporters planned mass protests in downtown Mexico City.

The rising tension is spurring concern about instability. For a quarter of a century, with the exception of the 2000 vote, the country's presidential elections have triggered crises. One poll shows some 80% of Mexicans oppose any move to strip the mayor of his immunity. If voters conclude the election is being rigged, there is no telling how they will react. In an Apr. 4 report, Merrill Lynch & Co. warned investors

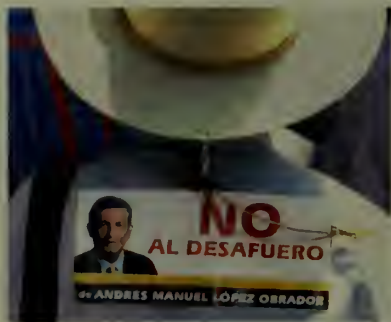
to take a "conservative approach" to Mexican securities until López Obrador's legal situation is resolved. The Bolsa has fallen 11.3% since early March as the debate heated up. "The protests are worrying politicians, businesspeople, and even religious figures because they could destabilize the country," Mexican news agency Notimex recently editorialized.

Friend to the Downtrodden

LÓPEZ OBRADOR is easily Mexico's most popular politician. He has won over the capital's voters by handing out free school supplies and \$65 monthly pensions to local senior citizens. And he built a new highway that has cut commuting time in the city. "He's the great hope for the downtrodden," says Luis Pichardo, 72, a retired carpenter who receives a local pension. "But his opponents will do anything to shove him out of the way."

The confrontation with the PRI and the PAN is giving López Obrador a publicity boost. He aims to play that card against his likely chief opponents, 52-year-old PRI President Roberto Madrazo, and Santiago Creel, 50, the expected PAN candidate and a Fox Cabinet member. The PRI boss appears to be backed by the business elite, who worry about López Obrador's populism, and by former President Carlos Salinas de Gortari. If López Obrador winds up in court, his lawyers might try to obtain an injunction to allow him to register as a candidate until his case is resolved. If he is blocked from running, Mexico can expect more tumult—and the biggest casualty of all could be its nascent democracy. ■

—By Geri Smith in Mexico City



OUTRAGE López Obrador is wildly popular

GLOBAL WRAPUP

PERNOD RICARD MAKES ITS MOVE

FRENCH LIQUOR company Pernod Ricard may finally slake its thirst for a big acquisition. The company confirmed on Apr. 5 that it has teamed up with **Fortune Brands** of the U.S. to bid for its bigger rival, **Allied Domecq** of Britain, in a deal worth an estimated \$17 billion. The two buyers would carve up Allied Domecq's brand portfolio, with the majority going to Pernod, vaulting it from global No. 3 to No. 2 behind Britain's **Diageo**. Pernod, maker of Chivas Regal and Martell cognac, is looking for a stronger U.S. foothold, which Allied Domecq brands such as Stolichnaya vodka and Ballantine's whisky could provide. Fortune, maker of Jim Beam bourbon, could stock up on Allied Domecq's wines.

A LOOMING BATTLE OVER TEXTILE TRADE?

FACING SURGING imports of textiles and apparel from China in the first quarter—up overall 62.5% and in some categories more than 1500%—the **U.S. Commerce Dept.** said on Apr. 4 it is launching investigations that could lead to new tariffs on cotton knit shirts and blouses, trousers, and underwear. The move comes after quotas on mainland textiles and apparel were lifted on Jan. 1 when the Multi-Fiber Agreement ended. On Apr. 6 the **European Union** also set guidelines for considering restrictions on Chinese textile imports. The 2001 agreement that brought China into the **World Trade Organization** says WTO members are allowed "safeguard" measures, including tariffs, if growth in Chinese textile and apparel imports disrupts local markets. Beijing criticized the U.S. and EU announcements.

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> Storage experts have engineered an innovative dialogue between large customers and their vendors that is already helping shape a new generation of technology. The goal: to keep pace with and even anticipate the red-hot demand for storage solutions.



> IT organizations have a collective headache, and its name is data storage. This technology discipline was once the province of back-room system operators charged with saving and preserving data in case of corruption or a need for disaster recovery. Now storage has evolved into a top-level business preservation and risk mitigation concern for CIOs, CEOs, and boards of directors.

As the importance of storing and protecting corporate data assets has grown, the pressure on IT and business executives has skyrocketed. New compliance and corporate governance requirements have put information storage under a microscope, and the IT function never seems to be budgeted sufficiently to hire enough qualified staff. The challenge of managing burgeoning volumes of information has become a serious pain point – but help is on the way.

Storage vendors, sensing both the problems of their customers and the opportunity to meet a need, are hastening to invent and innovate. In the last two years, the industry has introduced a variety of new technologies and products designed to address these complex requirements – without busting IT budgets. But the maturation of the data storage industry is not one-sided. As end-user organizations sense vendors' willingness to meet them halfway, customers are increasingly speaking out – about their existing frustrations, the technology enhancements they need to solve their problems, and the best practices they need to learn to optimize the technology.

"As a collective voice, users have the opportunity to quantitatively define market segment needs and help vendors more rapidly understand the market business opportunities," says Wayne Adams, chairman of the board of the Storage Networking Industry Assn. (SNIA), in San Francisco. "Users are articulating their needs in terms of applications and solutions, IT challenges, and corporate

*Sponsored by the
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"VIRTUALIZATION CAN NOT ONLY MASK COMPLEXITY, IT CAN ALSO HELP SIMPLIFY THE STORAGE ENVIRONMENT BY HIDING TECHNOLOGY CHANGE FROM END USERS," SAYS HI YOSHIDA OF HITACHI DATA SYSTEMS.

business issues. Industry associations such as the SNIA aid the vendor community by translating these needs into technical requirements that can be served with best practices, industry standards, and education."

SQUEEZED FROM ALL SIDES

Even if there were no other storage challenges, the sheer growth of the volumes of data stored by the average company would be enough to give any business or IT professional pause. In less than a decade, businesses that once stored "only" megabytes of data are routinely managing terabytes and even petabytes.

From every angle, the need to maintain data

increases the pressure on budget-constrained IT departments and companies. Capacity growth continues unchecked, with organizations processing increasingly greater numbers of transactions that need to be saved and stored for near- and long-term periods. New compliance requirements, such as the Section 404 requirement of the Sarbanes-Oxley Act, demand that IT professionals protect an increasing volume of data; moreover, they must be able to provide "timely" access to specific files and applications — even e-mail messages. Yet a commensurate expansion in storage headcount is not within the budget of most organizations, creating a backlog of requests and long working hours for operators and administrators.

Storage vendors are on the case. Solutions range from vendor to vendor, but the common

thread is a desire to use technology to streamline storage tasks, automate routine processes, and reduce complexity.

PROTECT THE DATA

For Hitachi Data Systems Corp., in Santa Clara, Calif., virtualization is the key to supporting organizations' storage infrastructure simplification strategies. As defined by the SNIA, "virtualization" occurs when one or more back-end services or functions are integrated with additional front-end functionality. The goal is to provide useful abstractions that hide complexity or add new functionality. HDS's virtualization enables users to access its storage as well as selected third-party storage devices through a single interface. The virtualization resides in the Hitachi TagmaStore



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"AS A COLLECTIVE VOICE, USERS HAVE THE OPPORTUNITY TO QUANTITATIVELY DEFINE MARKET SEGMENT NEEDS AND HELP VENDORS MORE RAPIDLY UNDERSTAND THE MARKET BUSINESS OPPORTUNITIES," SAYS THE SNIA'S ADAMS.

Universal Storage Platform's control unit, enabling customers to manage their storage devices with the same software functionality and commands that they use with the HDS products.

"Virtualization can not only mask complexity, it can also help simplify the storage environment by hiding technology change from end users," says Hu Yoshida, chief technology officer for HDS. "The technology changes every 18 months, but the capitalization rate for most companies is either three or five years. So we see virtualization as an important ROI opportunity — where companies can use virtualization to map new functionality across depreciating storage assets to reduce their operation expenses going forward."

With the pressures of Sarbanes-Oxley

heating up, Yoshida says that companies need a broader view of what comprises an appropriate storage strategy. "The prime requirement of Section 404 is to protect the data," he says. "That means that customers must be more sophisticated about meeting their storage requirements, considering not just capacity but the whole ROI picture. Can you satisfy your internal and external auditors? Do you have safe multi-tenancy, where different systems and applications are prevented from overwriting the other's data? And when you protect the data, are you able to ensure its integrity during its retention period? Can you reduce your costs by seamlessly moving less active data to different tiers of storage?"

Yoshida points out that modular storage provides a reduction in capital costs, but it lacks the advanced functionality and the

horsepower to provide data protection features such as mirroring, replication, and migration without affecting performance. The virtualization offered in the TagmaStore Universal Storage Platform can map high-end functionality across existing modular storage as well as move data to the appropriate storage tier. This enables customers to optimally match applications to storage attributes and cost-effectively meet the data protection requirements of Sarbanes-Oxley. "Making sure all of these issues are covered requires a longer-term view about storage," he says.

CAN YOU HEAR ME NOW?

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December 5-8, 2005 – New York, NY USA
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SPECIAL ADVERTISING SECTION

to find their voice as a community.

Leading the way in helping users get what they need is the SNIA End User Council (EUC), a group of more than 100 member companies worldwide. Formed in late 2003, the EUC was created "to aggregate and amplify the voices of the end users and give them a connection point with the decision-makers in SNIA," says Laurence Whittaker, chairman of the SNIA EUC, who is also a supervisor of enterprise storage management at Toronto-based Hudson's Bay Company, Canada's largest department store retailer. The EUC's goal is to provide a direct voice into the storage networking industry, creating a forum for shared communication that benefits both customers and technology developers. Customers also share information within the council.

The EUC facilitates this exchange via monthly conference calls and semi-annual meetings at the Storage Networking World conference. In both venues, the EUC hosts presentations by industry leaders, conducts focus groups for the SNIA's technical work groups and forums, and hosts open discussions on a variety of topics and storage management issues. "Much of the discussion not only helps define the EUC objectives and priorities, but provides direct input and feedback to the industry via SNIA," says Whittaker.

LEAD, FOLLOW, OR GET OUT OF THE WAY

A founding member of the SNIA EUC is Norman Owens, a business technologist with Carlson Companies, one of the largest privately held companies in the U.S. The company, headquartered in Minneapolis, is a global leader in the hospitality, marketing, and business and leisure travel industries, with brands such as Radisson Hotels & Resorts, T.G.I. Friday's, and Carlson Wagonlit Travel. Its centralized technology group, which provides IT services throughout the Carlson enterprise, experienced a 300% growth in storage volumes within the last year.

Getting involved in the EUC is helping Carlson become a leader in employing effective storage practices. "In the EUC you meet the top tier of storage end users," says Owens. "These people have the greatest motivation to create solutions. And I find that the people who are doing the most innovation are also the most anxious to share information and best practices about what works for them."

Owens appreciates the accelerated training he has received through the EUC, as well as the opportunity to discuss the issues of using one vendor's storage technology versus blending the products of multiple vendors in one storage environment. "These discussions give users a finer distinction, better focus on our challenges," he says. "And I like hearing about best practices from other users, rather than just from vendors. We are all in the same boat with storage. The information we share helps us all to do our jobs better."

In addition, the group's influence seems to be expanding within the storage vendor community. "Within SNIA, we are getting calls from many groups and committees, asking for end users who can review technology specifications, provide feedback on strategies, and participate in their discussions," he says. In fact, the group's perspective is in such demand that the EUC needs more members to field requests for participation in the SNIA work groups and conferences. "The vendors are starting to hear us now. We no longer have to insist on being included."

WEB DIRECTORY

Hitachi Data Systems Corp.

<http://www.hds.com>

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<http://www.sap.com>

Storage Networking Industry Assn.

<http://www.snia.org>

For more information on working with
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How Ampex Squeezes Out Cash

It's suing high-tech giants that rely on its patents. Will its stock keep on soaring?

JUST A COUPLE OF YEARS ago, Ampex Corp. looked like a long-fading technology pioneer finally slipping into oblivion. The Redwood City (Calif.) company, founded in 1944, proved itself one of Silicon Valley's greatest innovators in its early days. Among other things, it invented the commercial video recorder in 1956 and developed the first U.S. tape recorder in 1948. But Ampex lost its magic touch decades ago. A string of new ventures flopped. After losing money for years, Ampex was dumped from the American Stock Exchange at the end of 2003, with its stock at 68¢.

Surprise, surprise—Ampex is back. The forgotten innovator has one of the hottest stocks on earth, with the share

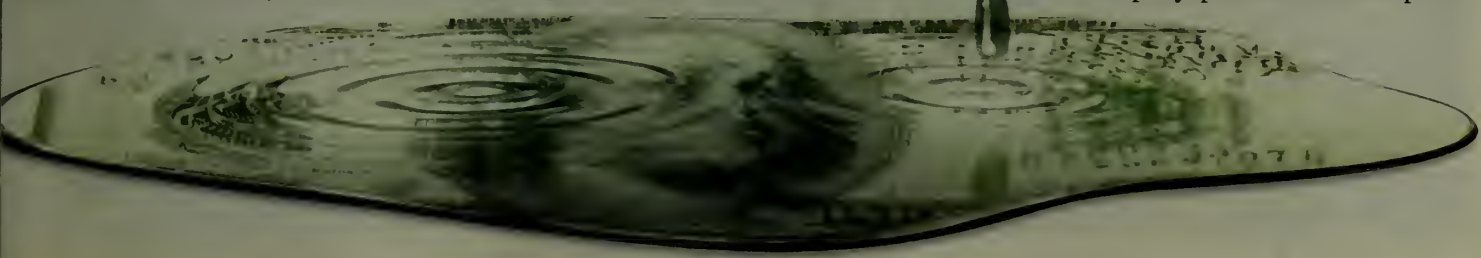
price skyrocketing in the past year from \$1 to \$40. What happened? In a word, patents. Ampex dusted off a number of its patents and began filing lawsuits against a Who's Who of consumer-electronics giants, including Sony, Sanyo Electric, and Eastman Kodak. Ampex' claim: It holds the intellectual-property rights to how digital images are displayed in nearly every digital camera, camcorder, and camera phone on the market.

It's no empty bluff. Since last fall a string of Asian companies have cut licensing deals with Ampex, agreeing to pay a total of \$77 million. Sony alone is spending \$40 million for the right to use Ampex' patents through April, 2006, and then will pay ongoing royalties. The largest outstanding claim may be that against Kodak, which so far has re-

fused to cut a deal. Ampex' prospects have improved to the point that the company says it will apply for a listing on NASDAQ by the end of April.

But this is no simple turnaround story. There are a number of unanswered questions about the continuing value of Ampex' patents and about the leadership of Edward J. Bramson, a press-shy British financier who serves as the company's chief executive. Bramson gained control of Ampex in 1987 when his investment firm, Sherborne & Co., acquired the company in a leveraged buyout for \$479 million. Since then, Ampex has entered into a series of transactions with at least four investment companies Bramson owns or controls. In one case, Ampex lent two Bramson-controlled companies money to buy shares in Ampex. Then in 2002 the two Bramson entities defaulted on \$2.8 million in outstanding loans. In addition, the Web site of one Bramson company said that he had worked at Goldman Sachs & Co., in corporate finance and mergers and acquisitions. However, after *BusinessWeek* notified Ampex that Goldman Sachs had no record of Bramson's employment, an Ampex spokesman said he had never worked for the Wall Street firm and that the statement would be removed from the Web site.

There are also questions about whether Ampex is disclosing enough information about its licensing deals. In filings with the Securities & Exchange Commission, the company provides the lump-sum



payments from Sony and others. It doesn't disclose the actual terms of the licensing agreements or the expected ongoing royalties. It's unclear whether that violates SEC rules. However, some governance experts say it could leave investors in the dark about the company's financial prospects. "I think they should file the whole agreement," says Kevin J. Cameron, president of Glass, Lewis & Co., a research firm in San Francisco that analyzes issues of corporate integrity. The Ampex spokesman declined to comment on the issue.

Ampex has taken a step toward broader disclosure in recent days. On Apr. 5, during a rare public appearance, at an investor conference in San Francisco, Bramson gave estimated expiration dates for four groups of patents and a breakdown of royalty revenues from digital cameras, camcorders, and other devices. He also said that camera-equipped cell phones will provide a major opportunity for future licenses. "We notified the makers [of camera phones] at the end of last year, and we're starting discussions with them this year," said Bramson. He did not estimate total future royalty payments for the company.

DIGITAL GOLD MINE

AMPEX' FLURRY of lawsuits is one example of the intensifying debate over intellectual-property rights in the U.S. As patent-infringement lawsuits have soared in recent years, critics have railed against what they call "patent terrorists" and "patent trolls," and complained that the litigation is a tax on innovation. "There's no socially useful purpose," says Ron E. Shulman, a lawyer at Palo Alto law firm Wilson Sonsini Goodrich & Rosati. Patent advocates disagree. They say pat-

ents are essential to protecting innovation and point out that many respected companies, including IBM, have been cashing in on them for years.

While Ampex has come under fire for its aggressive pursuit of royalties, there's no question its patents have become a gold mine. One patent covers the display of compressed digital images, individually or in a group of up to 16. Nearly every digital camera, and many other devices, let people view such thumbnails to help them navigate through a series of images quickly. Royalties from that broad patent helped

Ampex turn a profit of \$47.1 million in 2004 on revenues of \$101.5 million, according to its preliminary financials, after losing money the five previous years.

A deal with Kodak could mean another rich payday. Kodak, which declined comment, was the top seller of digital cameras in the U.S. last year, with 21.4% of the market. J.M. Dutton & Associates, an El Dorado Hills (Calif.) research firm that charges Ampex and other companies it covers for research, estimates Ampex could bring in \$275 million in royalty income over the next four years. Dutton's Richard W. West, the only analyst covering Ampex, has put a 12-month price target of \$77 on the stock.

But a close examination of Ampex' financial and legal documents raises questions about how to predict the company's performance accurately. In its court filings, Ampex specifies only one patent that it claims has been infringed: U.S. Patent No. 4,821,121, typically referred to as the 121

patent. This is the patent that covers technology allowing people to view thumbnail images of photos rapidly. But the patent granted in 1987, expires on Apr. 11, 2006. Bramson said in his presentation that that patent accounts for all the royalties Ampex is getting from digital camera sales.

Ampex says it holds more than 600 other patents, and royalties from those may be substantial in the future. The company says its other patents cover digital image processing, data compression, and image decoding, and those claims expire between 2012 and 2014. But it does not reveal

which patents companies are licensing, beyond the 121 patent, and the specific terms of any agreements.

The company's lack of disclosure may run afoul of SEC rules. The commission requires companies to file a summary of commercial agreements at the time a deal is struck and the full agreement with its next quarterly statement, if the

agreement is "material." There are exceptions to the rule, including measures to protect trade secrets. But experts are skeptical that something like the Sony deal, accounting for 40% of Ampex' revenues last year, would not have to be explained to investors. "More extensive disclosures may be required," says James R. Doty, a securities lawyer with the firm Baker Botts.

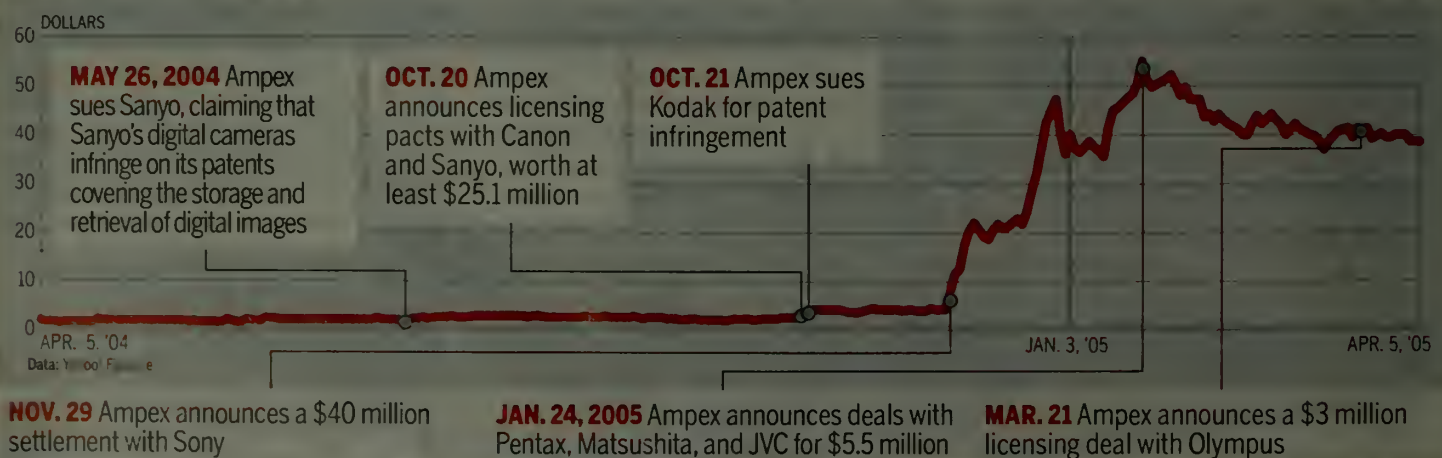
Can Ampex keep its stock soaring? Perhaps. But to do so, the company may have to give investors a closer look at its tightly guarded patent deals. ■

—By Spencer E. Ante in New York, with Justin Hibbard in San Francisco

Ampex claims rights to an imaging process used in most digital cameras

Cashing In on a Patent Stash

In the past year, tape-recorder inventor Ampex has won nearly \$77 million from Sony, Canon, and other electronics giants to settle liabilities for use of its patents. Its shares leaped from 1 to 40.



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Combat Over Collaboration

Microsoft and IBM are fighting to control the info-sharing software market

STARKEY LABORATORIES Inc. is known for its high-end hearing aids, but until recently the process that engineers at the Eden Prairie (Minn.) company used to design them was decidedly low-end. They would cook up a design concept and then e-mail it to colleagues so they could make changes. But because multiple copies of each design were circulating, there was a lot of confusion about which version was the most up-to-date.

Rather than wait for Starkey's tech department to deliver a solution, a group of frustrated engineers took matters into their own hands. They used Microsoft Corp. software to covertly set up an internal Web site for collaboration. They were able to go online to set common goals and deadlines, and to maintain one version of

a design for their project that anyone could modify. "It immediately increased productivity," says Timothy D. Trine, vice-president for hearing research and technology. Starkey now has 450 collaboration Web sites for various projects.

KEY SOURCE FOR GROWTH

IF MICROSOFT GETS its way, software that lets workers like those at Starkey collaborate anytime and anywhere is finally going to reach the masses. The tech giant is making collaboration one of its top priorities, ratcheting up the competition in one of the most dynamic segments of the software industry. "There's certainly this gigantic opportunity in making workers more productive," says Microsoft Chairman William H. Gates III.

The company's goal is to make the software as easy to use as Word, Excel, or Outlook—the core programs in its Office

application suite. Microsoft itself has spent more than \$300 million on two startups and billions more on developing collaboration technologies. On Mar. 15, it began a \$100 million Office ad campaign. And by the end of June it will launch Office Communicator 2005, a program designed to make it far easier for workers to initiate everything from an instant messaging dialogue to a phone call to a video chat session—all from one application.

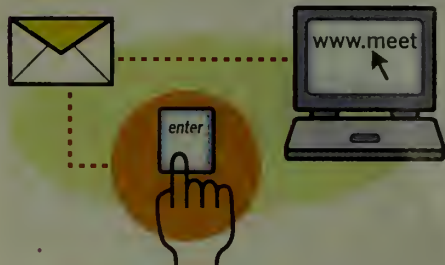
Microsoft is going head-to-head with another software giant: IBM. Big Blue's Lotus Notes software pioneered the collaboration market and now has 118 million users. Last year, IBM began rolling out a new package of applications, called Workplace, that combines collaboration capabilities with the programs workers use to do their jobs every day. Says Steve A. Mills, IBM's executive vice-president for software: "Our game plan here is to be a major player in this next generation."

Both companies see collaboration as a vital source of revenue growth. The \$4.4 billion market, the largest part of which is e-mail, is expected to climb at a respectable 8% this year, vs. 6% growth for all software. The hottest niches—Web conferencing, corporate instant messaging, and team collaboration Web sites—will grow 27% this year, to \$1.8 billion, estimates tech research firm IDC.

Microsoft's latest move is a direct challenge to IBM. In March, it agreed to pay \$120 million for Groove Networks Inc., run by Lotus Notes creator and former IBM star Ray Ozzie. Groove uses peer-to-peer technology—the stuff teenagers use to illegally swap music files—to let workers at different companies easily collabo-

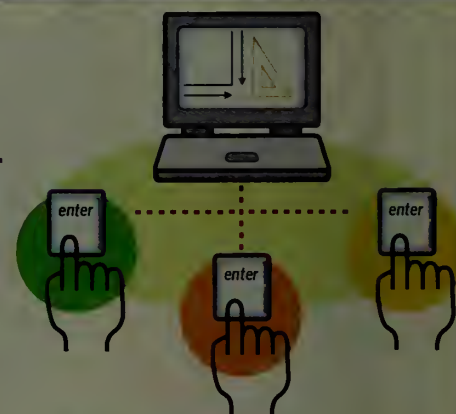
Virtual Meetings on the Fly

Here's how the latest collaboration technologies work, illustrated by a scenario at fictional company Double Eagle Sporting Goods.



1. CONTACT Product V-P Jane Smith sends an e-mail to Don Jones, president of Noonan Clubs, a design firm, setting up a video Web conference to discuss a new golf club design. The e-mail includes a date for the meeting and a link to launch the session.

2. INITIAL MEETING Once the Web conference starts, the participants see live videos of each others' faces on their computer screens. They look at photos of golf clubs, sketch designs on a shared "virtual whiteboard," and review contracts.



3. PRODUCT DESIGN Noonan designers and Double Eagle planners use peer-to-peer software that allows them to share spaces on each others' computers. The program lets them take turns modifying designs and tracks all the changes. Alternatively, they could set up an internal Web site to share ideas.

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rate on projects through corporate firewalls. IBM doesn't offer a rival technology. "This is a kick in the gut to IBM," says Erica Rugullies, senior analyst at research firm Forrester Research Inc.

Even before the Groove deal, Microsoft was gaining the upper hand. In 2003 it bought PlaceWare Inc., the No. 2 player in Web conferencing behind WebEx Communications Inc. Analysts believe Microsoft has been growing faster than No. 3 IBM since. Its big advantage is being able to capitalize on its installed base of 400 million Office users by placing easy-to-use links from those applications to its new collaboration software and services. That helped it increase its number of Web conferencing customers 41% since the PlaceWare acquisition. "Microsoft can push these products and get them in front of users," says IDC analyst Robert P. Mahowald.

But IBM will be a worthy rival—especially in large organizations. Its Workplace melds such desktop programs as word processor and spreadsheet with collaboration software and promises to make it all less expensive and easier to manage than typical desktop computing setups. San Francisco State University, for instance, plans to use Workplace when it's rolled out early next year to give all 32,000 students and faculty the ability to search class information, dig through research documents, and collaborate with one another. "The idea is to really have an electronic campus," says Jonathan Rood, associate vice-president for the university's division of information technology.

While customers are kicking the tires, Microsoft and IBM are kicking each other. Gates dismisses IBM as a serious competitor since so many of its desktop programs, such as the Lotus 1-2-3 spreadsheet, are afterthoughts in today's market. "It's hard for a company that has been out of it for so long and had the various failures they've had to wake up and say, 'We care about information workers,'" he says. To Mills, it is Microsoft that is stuck in the past. "Their world is the world of e-mail, not the world of collaboration," he says. Their verbal salvos don't mean much, but as long as they back their talk with innovative new products, customers such as Starkey Labs and San Francisco State will be the real winners. ■

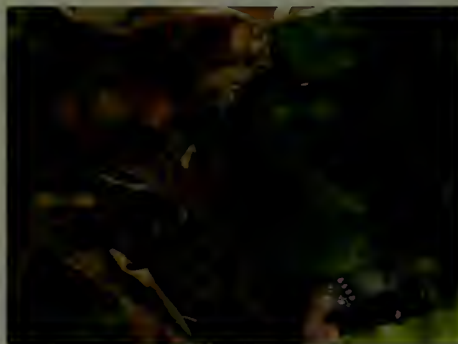
—By Jay Greene in Redmond, Wash.

BusinessWeek online For Q&As with Microsoft's Bill Gates and IBM's Steve Mills go to businessweek.com/extras

Less Bang For the Big Guns

The defense biz is hot, but the most profitable contractors are the little guys

IN LATE JANUARY, THE U.S. AIR Force had some bad news for Lockheed Martin Corp.: The world's largest defense contractor would earn no profits in 2004 or 2005 on a satellite system it is building to provide early warning of missile launches. Because of the skyrocketing cost, from \$1.8 billion to \$5.6 billion, of the Space-Based Infrared Systems-High program, \$10 million in fees are being deferred. The Pentagon will cover the overruns, but the Bethesda (Md.) company's profits, pegged to the original price, remain capped at \$200 million through 2011. That's a 3.6% margin at best and not much lower than the



GPS RECEIVER

Maker Rockwell Collins' stock is soaring

5.6% overall margin Lockheed made in 2004—\$2 billion in profits on \$35.5 billion in sales.

Nearly 1,000 miles to the west, margins are considerably more lush at \$3 billion Rockwell Collins Inc. The Cedar Rapids (Iowa) maker of aviation electronics sticks to safer jobs such as the \$600 million upgrade of the Air Force's KC-135 refueling tanker. Rockwell is replacing navigation and communications gear on the aging planes, often with off-the-shelf products such as weather radar

that it also sells for commercial aircraft. While the company won't disclose margins on individual programs, execs say its tanker deal is typical of its defense jobs, where profit margins exceed 18%.

"POLITICAL RED FLAGS"

TO THE PUBLIC, all military contractors are alike: big, politically connected, and fabulously profitable. But as Lockheed and Rockwell demonstrate, there's a split in the industry. Not-yet-published data compiled by the Center for Strategic & International Studies and obtained by *BusinessWeek* show that suppliers have higher profits as a percentage of sales than the titans. From the Reagan buildup in the 1980s through the Bush surge in 2004, prime contractors averaged 6.3% profit margins, vs. 8.5% for subcontractors.

Wall Street tolerated the primes record for much of that period, with value funds treating them like utilities—steady income producers—while the zippier suppliers show up in growth funds. "The [primes'] cash flow is enormous," notes Frank C. Lanza, CEO of supplier L-3 Communications Holdings Inc. "[And] they have no risk" because costs are reimbursable. But with defense procurement slowing, investors may get wary. "I have negative ratings on most of the large, integrated defense contractors," says Robert Friedman, an analyst at Standard & Poor's.

Despite their enormous political clout, such household names as Boeing, General Dynamics, and Northrop Grumman are under Washington's microscope and have to be content with microscopic margins. High margins "raise political red flags," says John Montgomery, managing director of Montgomery Brothers Inc., a Wash-



LOCKHEED RAPTOR
Air Force orders
for the plane
have shrunk

ington investment-management firm.

Suppliers—and their richer profits—fly under Washington's radar. They can spread development costs across commercial and military sales. Subcontractors are “a lot more commercial, a lot more responsive, and a lot more efficient,” says Gordon Adams, a defense expert at George Washington University. That's one reason for the 136% jump in Rockwell's shares since Jan. 1, 2002, which dwarfs the 34% rise for Standard & Poor's Aerospace Index (table). The suppliers also are merging to gain more clout in negotiations with the big guns: The number of middle-market mergers rose 33.8% in 2004 and is climbing at a 63.4% annualized clip, according to Jeffries Quarterleck, a unit of Jeffries Group Inc.

The diverging fortunes of Lockheed and Rockwell show how the industry has evolved. For the primes, new contracts to build planes and ships are scarce these days. So when one goes out for bid, “you've got to win it,” says an executive

familiar with Lockheed Martin's thinking. That forces companies to lowball their bids. With good performance, a prime contractor can collect fees of up to 14% of costs—but those are calculated on the initial bid, and margins drop as costs inevitably rise. And those hard-won contracts seldom lead to the long and profitable production runs promised. Lockheed Martin was supposed to build nearly 800 F/A-22 Raptors, for example, but the order now is well below 200.

Subcontractors, in contrast, get paid a fixed price. “Any efficiencies you get to keep,” says Rockwell Collins CEO Clayton M. Jones. Fewer contracts now impose special military specifications, which produced those infamous \$600 toilet seats. So Rockwell Collins can use the same production lines as it splits its business evenly between government and commercial work and between domestic and international markets. Suppliers also enjoy healthy sales in upgrades and parts.

To remedy their sluggish image, woo investors, and shift risk, the primes want to jack up profits while shrinking the capital they commit. Lockheed Martin boosted return on invested capital from 6.1% in 2002 to 11.9% in 2004, largely by cutting debt. And in a Jan. 13 internal memo, Lockheed Martin Chief Financial Officer Christopher E. Kubasik told execs that capital should be invested only as a last resort. Such strategies could spark a struggle between the primes and subs over who foots the

investment tab, since the goal for both is to earn more money with lower capital outlays.

The Pentagon is helping this push by the primes by hiring them to serve as “lead systems integrators” (LSIs) for defense programs. The idea: let contractors use their expertise to buy rather than build components and stitch together complex weapon systems. The prime contractor mostly sells brainpower, while suppliers make the heavy investments. For the LSI, “a 6% margin on zero investment is a heck of a good return,” says Daniel J. Murphy Jr., CEO of Alliant Techsystems Inc. in Edina, Minn., a maker of munitions and propulsion systems.

NEW STRATEGY, IFFY RESULTS

THE LSI APPROACH explains how Lockheed Martin—which doesn't own a shipyard—can vie for lead contractor on the Navy's new shallow-water ship. And why Boeing, which doesn't build tanks, is the lead on the Army's \$100 billion-plus Future Combat System, a collection of combat vehicles linked by a high-tech network. But there's growing disenchantment with the LSI idea. The Army has restructured the Future Combat System to cope with technical and cost woes. “This is not regarded as a success,” says one Pentagon insider.

While the primes want to emphasize their improved return on investment, the subs are beating them at that game, too, according to the CSIS data. And they're not likely to let the primes drag down their margins. All of this raises the question of who will make the investments needed to preserve the nation's defense industrial base. Until that question is answered, the smart money is riding on the little guys. ■

—By Stan Crock in Washington

Where the Action Is

Second-tier defense contractors put up some top-flight numbers

COMPANY	PROFIT MARGIN 2004	REVENUE GROWTH † 2002-04	STOCK RISE † 1/1/02-3/23/05
L-3	10.9%	72%	64%
ROCKWELL COLLINS*	18.4	38	136
DRS TECHNOLOGIES	10.7**	94	19
ALLIANT TECHSYSTEMS	10.1**	31	43
S&P AEROSPACE INDEX			34%
S&P 500 INDEX			1.5%

*Government systems **Nine-month data 2005 † Not annualized
Data: Company reports Bloomberg Financial Markets

Never mind computers and tech services. IBM's radical new focus is on revamping customers' operations—and even running them. **BY STEVE HAMM**

BEYOND

IT WAS OVER A LUNCH IN CINCINNATI TWO years ago that IBM Chief Executive Samuel J. Palmisano got his first inkling of Big Blue's next act. Palmisano was talking business with A.G. Lafley, CEO of Procter & Gamble Co., one of IBM's big customers. At one point, Lafley asked Palmisano to estimate how many of P&G's 100,000 employees it truly needed to keep on its payroll. When Palmisano didn't venture a guess, Lafley stunned him by saying that P&G might be able to get by with only a quarter of its workforce. Specialized service companies might be able to handle everything else, from human resources to customer care.

For IBM's new CEO, Lafley's idea delivered a strong jolt of the future. "We saw it as an industry shift," he recalls. Palmisano was already an expert in technology services, such as running data centers and managing companies' computing operations. Working under former CEO Louis V. Gerstner Jr., he had helped rescue a struggling IBM in the '90s by building its then-modest services division into a \$40 billion behemoth. But what Lafley was suggesting was far bigger. It stretched beyond revamping computer systems and stitching together new networks. If other CEOs were enter-

LOOKING FORWARD
Instead of defending markets, Palmisano is making new ones



taining similar thoughts, a vast new market could emerge.

Over the past two years, Palmisano has built these concepts into a strategy that would be laughable—if it weren't so serious. His goal is to free IBM from the confines of the \$1.2 trillion computer industry, which is growing at just 6% a year. Instead of merely selling and servicing technology, IBM is putting to use the immense resources it has in-house, from its software programmers to its 3,300 research scientists, to help companies like P&G rethink, remake, and even run their businesses—everything from accounting and customer service to human resources and procurement. “We’re giving our clients a transformational lift,” says Palmisano.

While Palmisano looks out at the world through thick glasses, he’s not short on vision. He expects that within 10 years IBM could build an annual revenue stream of as much as \$50 billion in business consulting and outsourcing services. If so, Palmisano will have created a second services miracle and hitched IBM to a crucial growth market. And in the process, his company will be fixing—or running—big chunks of the world’s business.

No Sure Bet

PALMISANO IS OUT TO TRANSFORM the very nature and image of Big Blue, a nickname derived a half-century ago from the company’s muscular blue mainframe computers. His goal is to carry IBM beyond that 20th century legacy, beyond computing and, yes, beyond blue—while making IBM as indispensable to clients today as it was during the heyday of mainframes.

The change at IBM is palpable. The number of employees focused on business rather than pure technology has leaped from 3,500 in mid-2002 to more than 50,000 today—out of a total of 330,000. And that’s growing at more than 10,000 a year. Meanwhile, in a painful process, other employees are exiting by the thousands—those in administration and computer repair, for instance, and from shuttered offices in Germany and Scandinavia.

Entire divisions are now in play. With the sale of the money-losing PC division to China’s Lenovo Group Ltd., Palmisano cuts loose a big piece of the company’s computer legacy. Meanwhile, he has snapped up more than a dozen business-service outfits in the past year, including Daksh, a 6,000-employee Indian customer-relations shop. Late last year he hired James Liang, a former Morgan Stanley mergers ace, to pick up the pace. “We’re committed to completely reinventing the portfolio over the long haul,” says Palmisano.

Yet getting there will be a slog—and coming out on top is no sure bet. To pull off his strategy, Palmisano must win a torturous trifecta: He must manage wrenching change inside IBM while, as a pitchman, convincing corporate customers worldwide to hand over their operations. And he must deliver decisive results. This means turning laggards into leaders everywhere from emergency rooms to blast furnaces. “I think IBM is on the right track,” says analyst Steven Milunovich of Merrill Lynch & Co. “But it’s not going to be clear for two years if they’re right or not.”

Why has Palmisano embarked on such a risky adventure? In truth, he has little choice. The world of computing that IBM long ruled is increasingly becoming a commodity business. Ruthlessly efficient Dell Inc., fresh from its conquest of the PC market, is climbing up in servers and even tech services. Dell’s services, which focus on setting up computer systems, are still small compared with IBM’s \$46 billion services business, but they are growing at more than 30% annually and are expected

MAKEOVERS & TAKEOVERS



R&D PARTNERSHIPS

IBM and **Boeing** have formed a 10-year R&D alliance to create technologies for network-centric warfare—where all the branches of the military and the intelligence services are linked via a network that allows them to share information and make battle decisions on the fly.



RETHINKING WHOLE INDUSTRIES

Mayo Clinic and IBM have teamed to pool the digital information. Mayo has on 4.5 million patients. Mayo researchers can now see the data for clues to better treatments. Eventually they hope to give doctors instant treatment guidance when they’re talking to patients.

to hit \$4 billion this year. “The big question is: Will services grow the same way hardware has? We think it will,” says Steve Meyer, a vice-president in Dell’s services unit.

IBM, with its legions of PhDs and closets full of patents, is not built to duke it out with the likes of Dell. Palmisano’s strategy promises a neat escape. Instead of battling in cutthroat markets, he takes advantage of all the low-cost technology by packaging it, augmenting it with sophisticated hardware and software, and selling it to customers in a slew of what he calls business transformation services. That way IBM rides atop the commodity wave—and avoids drowning in it.

The danger? Simple. An IBM stumble would spell slower growth and smaller profits, undermining its research-driven business model and its position atop the corporate tech world. Palmisano has only to reflect on IBM’s sorry state in the

combines its technology and management smarts to help clients fundamentally change the way they do things. Some of the variations on this double-barreled approach:



BUSINESS PROCESSES

IBM has taken over a large part of BP's finance and accounting in the U.K. and the Americas. Workers in remote locations such as offshore drilling platforms handle purchases of materials and parts locally—so there's no paperwork to get lost.

RESEARCHING BIG CHALLENGES

IBM's science research arm is helping the U.S. Postal Service come up with a new mail processing and distribution system for its 400-plus facilities nationwide. They'll use advanced algorithms to select the right transport—air, rail, or trucks—for each shipment.



TECHNOLOGY-LED TRANSFORMATIONS

IBM helped The New York Stock Exchange rebuild its electronic trading system so it could compete on an equal footing with all-comers. A key piece: handheld devices for floor traders that allow them to make and track trades.

NEW TYPES OF OUTSOURCING

IBM is experimenting with "intelligent transportation systems" for cities that want to ease traffic congestion. Stockholm is the laboratory. Drivers, identified electronically, pay variable tolls based on their status—commuter, tourist, taxi driver, etc.—and what time of day it is.

early 1990s to taste the consequences of falling short now.

The initial challenge is to make a grand vision that can sound threatening or full of hype into a must-have. McDonald's Corp., for instance, last year decided not to hand over its accounting and finance operations after IBM promoted the idea, opting to keep everything in-house instead. Even William H. Davidow, co-author of the 1992 book *The Virtual Corporation*, which championed the idea of handing off tasks to partners, cautions executives against going too far or too fast. "It would scare me to death if all my administration and strategy functions were outsourced to one company. You become a hostage," he warns.

To win over lukewarm customers, IBM might be tempted to offer overly favorable terms for unpredictable long-term contracts. This poses another risk. Time and again, tech companies have misjudged the actual costs of running companies' ever-

changing computing operations. As a result, they lose money on the deals for years. That's what happened with IBM's contract to run computing for JPMorgan Chase & Co., which the bank dissolved late last year when it took back control. That was a technology deal, not operations outsourcing, but the same uncertainties apply.

IBM faces strong competition as it forges into alien territory. The most potent rival is consultancy Accenture Ltd. The \$15.6 billion services giant has been dipping a big toe into business process outsourcing. While Accenture can't match IBM's tech skills or research staff, it outguns IBM in business expertise. "IBM is genetically a technology company," says Joel P. Friedman, president of Accenture's BPO unit. "I think our history of solving business problems and our industry knowledge gives us an enormous advantage." Accenture notched \$2.2 billion in



ON SITE Berman keeps close tabs on consulting client Virgin Megastores

promise to pretty profits, too. Analysts haven't made estimates yet, but IBM's senior vice-president for strategy, J. Bruce Harreld, says

the company will be able to achieve 20% operating-profit margins—double the margin in traditional tech services.

IBM's commitment to Wall Street is to deliver single-digit revenue gains and double-digit profit gains. Analysts expect the \$6 billion company to expand revenues 7% this year, not counting the spun-off PC unit. They project a 12.5% gain in earnings per share, so Palmisano is good for now. But analysts are nervous about a 7.5% decline in IBM's overall outsourcing backlog last year as the average length of IT deals declined. Palmisano is counting on gains from his

BPO revenues last year, up 50%, while IBM's business outsourcing and related revenues hit \$3 billion, a 45% gain.

Challenging both IBM and Accenture are aggressive Indian outsourcers, including Wipro and Tata Consultancy Services Ltd. Wipro's BPO business is going gangbusters and hiring about 1,400 employees per month. They offer customers lower costs but without the operational makeover IBM promises—which they view as risky. "We believe making changes at the customer end will be very hard," says T.K. Kurien, head of Wipro's BPO business. "Nine times out of 10 you'll fail."

new initiatives to sustain growth.

Investors, it appears, need more convincing. IBM's stock has been trading recently at about \$90 a share, after briefly reaching \$126 in 2002. The trouble? Palmisano is selling visions that can seem a bit vaporous to investors grounded in mainframes and tech services. With his business-services push, Palmisano is building on top of the "On Demand Business" campaign he launched 2½ years ago. The idea there: use advanced computer and software technologies to quicken the flow of knowledge within corporations so executives can react instantly to changes. That's still a work in progress. Now, with business services, it's as if he's building a big addition onto a house that's still under construction.

But Palmisano has gotten glimpses from early IBM deals of the magic that business outsourcing can work. In 2000, Marathon Oil Corp. wanted to trim costs in its finance department and at the same time give top execs an up-to-the-minute view into how the company was performing. IBM's consultants analyzed Marathon's business processes and suggested fixes. The average time to complete financial processes, such as accounts payable, shrank from 18 days to eight. They also built a "dashboard" on execs' PCs to help monitor the business. When the consulting project was complete, Marathon handed much

Glimpses of Greatness

STILL, IF PALMISANO AND HIS CREW fend off rivals and prove the skeptics wrong, the opportunities are enormous. Market researcher IDC estimates that in IBM's target markets, nearly half a trillion dollars are already flowing to outsourcers in everything from HR to industrial design. It expects the field to grow by 8% to 11% per year. Merrill Lynch's Milunovich figures that this new business could heat up annual growth in IBM Global Services from less than 5% a year over the next few years to as much as 9%, excluding currency effects. Business services

HOW IBM'S BUSINESS-SERVICES STRATEGY WORKS

Big Blue's methodology isn't set in stone, but here's how it played out with Marathon Oil

A PUSH FOR CHANGE

In 2002, Marathon Oil's executives want to trim costs in the finance department and put in place monitoring tools so that managers can follow daily operations and make quick adjustments. They call in IBM consultants and researchers to talk it over.

IBM RESPONDS

Big Blue's consultants and software developers analyze Marathon's business processes. They suggest ways to reduce accounts payable and other processes from 18 days to eight. They build a "dashboard" on execs' PCs to help monitor the business.

THE PATH FORKS

While some clients keep control of their business processes and technology supplied by IBM, Marathon hands much of its finance operations directly to Big Blue. Other customers go further, having IBM manage human resources and customer service.

IBM CREATES NEW PRODUCTS

IBM builds new businesses around the knowhow it develops for early customers such as Marathon. Already, IBM has sold the business-analysis dashboard it created for Marathon to more than a dozen other clients—and has installed it with an IBM client.



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of its finance operations directly to IBM in a seven-year, \$100 million to \$200 million outsourcing contract. "IBM is changing its definition from international business machines to international business models," says analyst David Cearley of researcher META Group.

IBM's early wins include groundbreaking contracts with some two dozen large companies and government agencies. Dun & Bradstreet Corp., for instance, just handed over some of its essential credit report data-processing operations to IBM. This is work that companies in the past would rarely entrust to outsiders. For the U.S. Postal Service, IBM is using complex algorithms from its research scientists to optimize mail handling and shipping. Then there's the unprecedented partnership with Boeing Co. The two companies are teaming up to create and market technologies for network-centric warfare.

Such joint projects call for a new type of IBMer—people like Saul J. Berman, a business consultant who came to the company with Price-waterhouseCoopers Consulting, which IBM bought in 2002 for \$3.5 billion. Berman's résumé includes stints as a management professor and a retail executive. IBM used to sell machines. Now, in a way, it sells well-connected teammates. Berman identifies so deeply with one of his clients, Virgin Megastores, where he's helping reorganize the handling of merchandise, that he seems like a staffer. When he travels, he invariably stops in at the local Virgin outlet and prowls the aisles looking for surprises or things that are amiss. If a CD is in the wrong spot, he'll move it back. It's like he owns the place.

Team Players

ON A RECENT RAINY NIGHT in Los Angeles, Berman gives a guided tour of the Virgin store on the Sunset Strip. Pleased that several dozen shoppers turned out in spite of the deluge, he ambles through the store pointing out newer types of merchandise, including cell phones and Ben Sherman designer clothing. He's trying to get Virgin to hire IBM to devise a strategy to help the retailer diversify to avoid being undercut by rampant Internet music pirating and steep discounting by Wal-Mart Stores Inc. "The question I ask the Virgin people is, 'Are you a music store or a lifestyle store? What are you?'" he says.

As IBM morphs from computer company into business partner, the blue-suited computer salesman of the past is being symbolically elbowed aside by people like Berman—who to Virgin dressed in black. But this makeover isn't as easy as hiring a batch of new employees to add new gloss. IBM is overhauling its workforce by retraining and redeploying longtime staffers, even some at the very top. For the past years, IBM Research manager William Pulleyblank ran the company's Blue Gene project, creating the world's most powerful computer. Now he has a very different role—as a business consultant. Late last year, IBM set up a Center for Business Optimization and put him in charge. Pulleyblank's task is to help



NEW DIRECTIONS

To broaden its knowledge, IBM has taken on some clients for free

business mathematics to solve the thorniest conundrums involving inventory management, pricing optimization, and the routing of shipments.

Even the vaunted 38,000-person sales force is undergoing a painful overhaul. In the 1990s, salespeople representing various IBM business units were essentially on their own, looking for hot opportunities to sell individual products or services. But Palmisano is busy "reintegrating" IBM in front of customers by bringing together specialists from computer software, consulting, and even research. That's tougher than it sounds. People who don't play well with others get replaced. These teams gather with customers, which often leads to discussions about business problems and strategies.

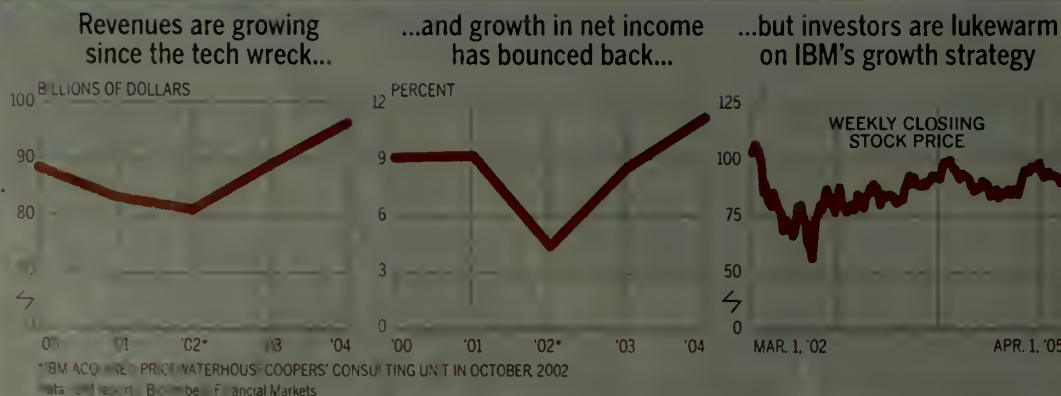
In its pursuit of vital industry experience, IBM—much like an eager college intern—is sometimes willing to work for free. IBM's unpaid partnership with the Mayo Clinic dates back to a cocktail party in 2000 in Mayo's hometown of Rochester, Minn., where IBM has a computer factory. A Mayo employee and an IBMer realized that scientists at both companies were working on genomics research. This soon led to joint projects on gene profiling of leukemia cells, and a published paper in a scientific journal in 2003. This is not the kind of connection that

Dell, Accenture, or Wipro are likely to make.

IBM and Mayo quickly moved on to a more ambitious project: changing the way medical research is done. They set out to gather data on 4.5 million patients and to make it easily searchable by researchers—without compromising patients' privacy. A research task that used to take for people a year can now be done by one person in 15 seconds. Eventually, Mayo and IBM believe, physicians will tap into a vast storehouse of data, real-time, when they are diagnosing patients. "This is the way to transform the way

PALMISANO'S PROGRESS REPORT

Here's how the IBM chief executive's first three years have gone:



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we practice medicine," says Dr. Nina M. Schwenk, chairperson of Mayo's Information Technology Committee. And for IBM, it's a foot in the door of the \$1.4 trillion health-care business.

While IBM had plenty of skilled engineers in Rochester, they practically needed brain transplants if they were to do breakthrough work for Mayo. So the company sent some of its brightest engineers back to school. Working with the University of Minnesota, the company arranged in 2003 for a series of three-day crash courses in everything from molecular biology to protein sequence analysis. So far, 50 people have taken the classes. Nothing illustrates more starkly the gyrations at IBM: Engineers who once worked on a fading family of main-frame-style computers are now helping to chart the future of medicine. "Part of your job is to be a visionary," says Jeffrey Tenner, one of the engineers. Now IBM is directing part of its

Rochester staff toward bioinformatics, privacy, and regulation compliance—all skills learned through the Mayo alliance.



Leveraging Success

WHILE IBM HAS FORGED cozy ties with Mayo, the business payoff is still unclear. IBM's goal with this alliance and others is to take lessons and turn them into products and services to sell within the industry. The Mayo work has led to a new software product for medical research. Other health-care products are on the way. And IBM is hoping one day to manage patient databases or networks of health-care organizations.

The Mayo alliance is now a model for forging research and development linkups with clients. Late last year, in quick succession, it struck up R&D alliances with Honeywell International Inc. and Boeing. The 10-year Boeing deal teams Boeing's military command systems expertise with IBM's facility with databases and collaboration. "This alliance with IBM is unique in the industry," says Roger F. Roberts, head of Boeing's Space & Intelligence Systems business. "We share our strategies, we share our R&D, and we offer joint solutions for customers."

IBM doesn't wait around for clients to come to it with R&D projects. Engineers are encouraged to dream up products and peddle them to potential customers. IBM engineer and cycling enthusiast Bryan Streimer, for example, rigged up a wireless heart-rate system to alert family members if a cyclist has a heart attack on the road. IBM channeled Streimer's invention into an electric pill dispenser, which it's developing for Danish electronic device maker Bang & Olufsen. If patients forget to take a pill on schedule, the device calls their cell phone. Now IBM is helping a British mobile-phone carrier build a new business offering wireless medical alert systems.

While the product design deals are nice one-offs, IBM's strategy hinges on winning broad long-term contracts. The seven-year, \$180 million contract with D&B that was announced last October shows how it's done. For D&B, IBM not only pulls together credit information on 63 million companies but also handles customer support, telemarketing, electronic credit-re-

ROMETTY IBM's consulting boss sells services clients have never considered

port distribution and crucial finance operations. IBM uses advanced analytics software to

size up D&B's customers and identify good prospects for additional services for the telemarketing staff.

A lot of these newfangled service deals haven't been around long enough to show results—but a few have. At Nextel, for instance, IBM's takeover of the company's customer-service operations helped improve its customer satisfaction ratings from also-ran to top of the heap. P&G is another success story. In January, 2004, IBM took over part of P&G's human resources in a 10-year deal valued at \$400 million. P&G has so far outsourced 3,500 jobs, including some in computing and customer relations. In HR, it had set 21 standards for speed and accuracy in such categories as

payroll and expense management. The IBM-run operations met them all. In the month before IBM took over, P&G had met only nine of the goals, according to market researcher Gartner Inc.

With those victories under its belt, IBM is scrounging for new markets. In addition to its four original businesses—accounting, HR, customer service, and procurement—it is now plowing into six others. They include after-sales service for consumer electronics, insurance-claims processing, and supply-chain optimization. The old IBM would have studied for many months before deciding whether to enter these new businesses. This time, it has set up small SWAT teams to work with a handful of initial clients and launch businesses. This is in some cases a tough sell. "These are markets we're making. A client may not have thought of doing this before," says Ginni Rometty, managing partner of IBM Business Consulting Services.

Plenty of pitfalls lie ahead. But for companies like IBM that bank on innovation, there's little choice but to create new markets and exploit them. "In the past, IBM defended the mainframe against client-server computing and PCs," Palmisano says. "We're not defending the past anymore." No, IBM is off and running into a new world of business, beyond computers. So long, Big Blue. ■

—With Spencer E. Ante in New York

More on IBM's Strategy at BusinessWeek.com

Big Blue meets Star Trek: IBM's Center for Business Optimization is using math to boldly go into new areas. William R. Pulleyblank, father of IBM's new Blue Gene supercomputer, is in charge of the enterprise.

The agile corporation lives: A Q&A with Steven Goldman, co-author of the 1995 book, *Agile Competitors and Virtual Organizations*, which presaged today's business outsourcing trend.

IBM's store of the future: A slide show highlighting technologies from IBM Research to transform retailing.

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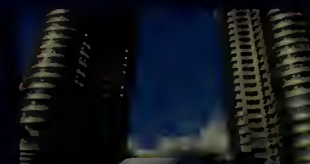
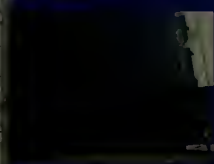
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A Payday for Performance

Compensation is less outrageous this year, except for CEOs who delivered

FOR GEORGE DAVID, THE brainy chief executive of the old-line industrial conglomerate United Technologies Corp., 2004 was another winning year. UTC racked up an 18% gain in net income, to \$2.8 billion, on 21% higher sales of \$37.4 billion. Shareholder returns of 11% were nothing to sneeze at, matching the Standard & Poor's 500-stock index. So did UTC's board shovel on the goodies when pay day came around? Not exactly. Sure, David's bonus rose, to \$3.5 million from \$2.8 million. But his grant of stock options actually shrank. In fact, it was only the rise in UTC's share price—reflected in an \$8.6 million valuation for those grants—that enabled the CEO to record a 16% raise in total pay for the year, to \$13.6 million.

In a year when profits and stock prices surged, rewards for CEOs such as David were generous. But *BusinessWeek's* 55th annual Executive Pay Scoreboard found that increases were moderated in 2004 by the continued impact of corporate reform, an ongoing shareholder revolt over astronomical pay levels, and pending accounting changes that are reining in the use of stock options. Our survey of 367 CEO pay packages showed that:

» Total CEO pay was up smartly, to an average \$9.6 million—a 15% increase from \$8.3 million in 2003. But that average was skewed by the outsize pay package of our most highly compensated CEO, Yahoo! Inc.'s Terry Semel, who received a package worth \$120 million made up almost entirely of options. Take him out of the mix and the average raise was 11.3%, not far off the rise in shareholder gains: The S&P 500-stock index increased 10.9%. CEOs of the nation's biggest com-



KING OF THE HILL
Yahoo! CEO Semel led the list with pay of \$120 million

panies by market capitalization took home a total \$3.5 billion in salaries, bonuses, and long-term compensation, including the value of 2004 option grants. Nearly two out of three CEOs saw their pay go up last year, with overall cash compensation rising 13.6% and long-term compensation increasing 15.6%.

» CEO raises and total pay once again dwarfed those of the average worker, who saw pay rise 2.9%, to \$33,176 per year. Nearly 40 of the nation's chief executives

walked away with more than \$20 million excluding windfalls from option exercise.

» There have been improvements, but pay for performance is still not the standard practice everywhere. Some boards, at least, are still lavishly rewarding CEOs who deserve far less. At Blockbuster Inc., for example, where operating income fell by nearly 50% and shares plunged by 47%, CEO John F. Antioco's pay increased 541% to \$56.8 million. One reason: The board replaced 4.3 million of his mostly underwater options with 1.6 million shares of restricted stock worth \$14.7 million as a "retention measure." That enraged governance experts, who called it a bailout for a CEO whose lackluster performance has destroyed billions in shareholder value in the past three years. The company says operating income was down due to a \$25

million investment in new initiatives, and says the stock was hurt by uncertainty over Viacom Inc.'s 80% stake in the company which it sold to the public in October. Say Blockbuster Chief Financial Officer Larry Zine: "We think we actually performed pretty well."

Elsewhere, pay and performance seemed better aligned. Tyco International Inc.'s Edward D. Breen Jr. landed a \$23.1-million package, up from \$3.7 million in 2003, for continuing his two-year turnaround of the once-troubled conglomerate. Sales were up 11%, profits nearly tripled and Tyco shares ended the year up 50%.

Pay anomalies are now easier to detect, thanks to a new methodology that *BusinessWeek* began using this year. Instead of counting the windfalls from option exercises as part of the annual pay package, as we have in the past, we're counting the value of annual option grants. The values are calculated using the Black-Scholes formula by Standard & Poor's, which like *BusinessWeek* is a division of The McGraw-Hill Companies. Our new formula also recognizes the new accounting reality of expensing, which requires companies to determine the value of options when granted and to deduct that amount from profits over a period of years. To standardize the Black-Scholes calculations, S&P uses standard inputs such as volatility, along with details of each option grant, including the exercise

million in 2004. With windfalls like those, both would have been at or near the top of our ranking using the old methodology. Semel still landed at the top of our pay scoreboard this year, thanks to new, gargantuan option grants. But David, with a total compensation of \$13.6 million, wasn't anywhere close to the top.

RICH REWARDS

ELIMINATING THOSE windfalls allows us to make more precise long-term comparisons. What we found when we compared the pay packages of today with the pay of CEOs from the late 1990s, using the same methodology, was enlightening. While the conventional wisdom holds that CEOs are getting more egregiously overpaid each year, in fact the truth is more complicated.

Consider Semel. His \$120 million pay-

Chambers (\$52.1 million), and General Electric's John F. "Jack" Welch (\$64 million) during that period—each of whom ran far larger companies. Yahoo declined to comment. But the compensation committee, in the annual proxy, notes that Semel's skills "make him an attractive candidate to competing organizations."

Even so, mega-payouts are a lot less common today. Sure, most workers would be glad to get an 11.3% raise—the average CEO increase without Semel—but it doesn't seem wildly excessive for a CEO who adds real value. The new restraint has a lot to do with the market correction of 2000 and the shareholder revolt against big pay packages that followed. In some cases, late-'90s pay packages ballooned because option values were inflated by unrealistic stock prices. Both former Tyco CEO

L. Dennis Kozlowski and former Computer Associates chief Charles B. Wang, for example, received massive option grants just as those stocks were approaching all-time highs.

At the same time, many long-time CEOs, like Oracle Corp. chief Lawrence J. Ellison, had options awarded many years earlier that could still be cashed in for huge profits, even after the market tanked. In 2001, Ellison cashed in 23 million options for a \$706 million gain. Ellison's payday was the largest ever, but he was hardly the only CEO who reaped improbably large rewards while regular investors watched their own portfolios evaporate. The resulting backlash prodded many boards to make changes. Among them: fewer options, more restricted stock, and tougher performance hurdles. Those changes, along with lower post-crash equity prices, brought many pay packages back to earth.

But those changes won't mean the end of huge option windfalls. The fact is that option stockpiles are now so big (table, page 80) that, if prudently managed,

many CEOs will be able to continue extracting sizable annual option windfalls from them for the foreseeable future. Only a handful of companies, like Microsoft Corp., have gone cold turkey and stopped granting options. At those companies option stockpiles will be exhausted in a

The 10 Highest-Paid CEOs

A new methodology, which counts annual option grants, gives a clearer picture of how chief executives fared

		2004 SALARY & BONUS	BLACK- SCHOLES VALUE OF OPTIONS GRANTED (MILLIONS)	OTHER LONG- TERM COMP*	TOTAL PAY	SHAREHOLDER RETURN	
1	Terry S. Semel	Yahoo!	\$0.6	\$119.5	\$0.0	\$120.1	67%
2	Lew Frankfort	Coach	2.4	53.5	2.9	58.7	82
3	C. John Wilder	TXU	17.8	0.0	37.2	54.9	177
4	Ray R. Irani	Occidental Pet.	5.1	8.0	24.6	37.8	41
5	Paul J. Evanston	Allegheny Energy	2.4	7.7	27.5	37.5	54
6	Robert L. Nardelli	Home Depot	14.1	8.7	13.9	36.7	17
7	Robert I. Toll	Toll Brothers	31.8	4.6	0.0	36.4	26
8	Bruce Karatz	KB Home	6.2	10.4	17.9	34.5	29
9	James E. Cayne	Bear Stearns	10.3	6.4	16.0	32.6	36
10	Edward J. Zander	Motorola	6.5	16.7	9.1	32.3	39

*Other long-term compensation includes restricted shares, regardless of vesting schedule, and long-term incentive plan payments
Data: Standard & Poor's ExecuComp

price. As a result, the option values used in *BusinessWeek*'s pay calculations may not match those disclosed by the companies.

Counting options at the time they're granted instead of when they're exercised results in some dramatic changes. Under the old formula, a CEO who exercised a big slug of long-held options could have catapulted to the top of our rankings—even though that windfall represented stock gains accumulated over many years. UTC's David, for example, exercised 1 million options for an \$83 million gain last year. Semel, meanwhile, cashed in more than 10 million options for \$230

million in 2004. With windfalls like those, both would have been at or near the top of our ranking using the old methodology. Semel still landed at the top of our pay scoreboard this year, thanks to new, gargantuan option grants. But David, with a total compensation of \$13.6 million, wasn't anywhere close to the top.

day made him the highest-paid chief executive in the *BusinessWeek* scoreboard. True, Semel's performance last year was outstanding, as Yahoo doubled sales, increased profits 253%, and delivered shareholder returns of 67%. Yet Semel's reward makes him even more overpaid than some of the biggest earning CEOs of the boom years. His compensation far exceeds the average pay packages of IBM's Louis V. Gerstner Jr. (\$42.6 million), Cisco Systems' John T.

The new restraint is partly due to shareholder revolts

The Corporation Executive Pay



Fortunes In the Future

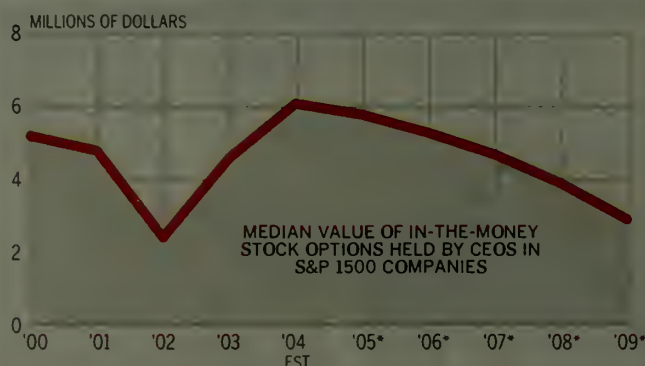
These chief executives still have huge rewards to reap from stock options that have yet to be exercised. Here are the top 12 treasure chests:

EXECUTIVE	COMPANY	VALUE OF NONEXERCISED STOCK OPTIONS (MILLIONS OF DOLLARS)
Richard D. Fairbank	Capital One Financial	\$560.2
Lawrence J. Ellison	Oracle	424.8
Terry S. Semel	Yahoo!	395.9
Irwin M. Jacobs	Qualcomm	365.9
Dwight C. Schar	NVR	352.5
Henry R. Silverman	Cendant	319.8
Howard Solomon	Forest Laboratories	318.5
Margaret C. Whitman	eBay	304.6
John T. Chambers	Cisco Systems	224.8
John W. Thompson	Symantec	193.3
Frederic M. Poses	American Standard	182.8
John W. Rowe	Aetna	164.7

Data: Standard & Poor's ExecuComp

Fade to Green

Even if CEOs exercise a third of their options each year and option grants fall, total options will take a long time to disappear.



*PROJECTION BASED ON 11% ANNUAL STOCK PRICE APPRECIATION, \$2 MILLION IN OPTION EXERCISES EACH YEAR, AND NEW OPTION GRANTS ADDING \$1 MILLION TO STOCKPILE IN 2005 AND DECLINING BY \$100,000 A YEAR

Data: Watson Wyatt Worldwide, BusinessWeek

FAIRBANK Capital One's CEO has a stockpile exceeding 11 million options—decade or less, since most options expire after 10 years. In 2004 the 200 biggest companies tracked by New York paid consultants Pearl Meyer & Partner granted options equal to 2% of their outstanding shares, down from 2.7% in 2000. CEOs saw the stock option portion of their pay packages decline from 51% to 37% in just one year—in part because grants of restricted stock increased.

BIG STOCKPILES

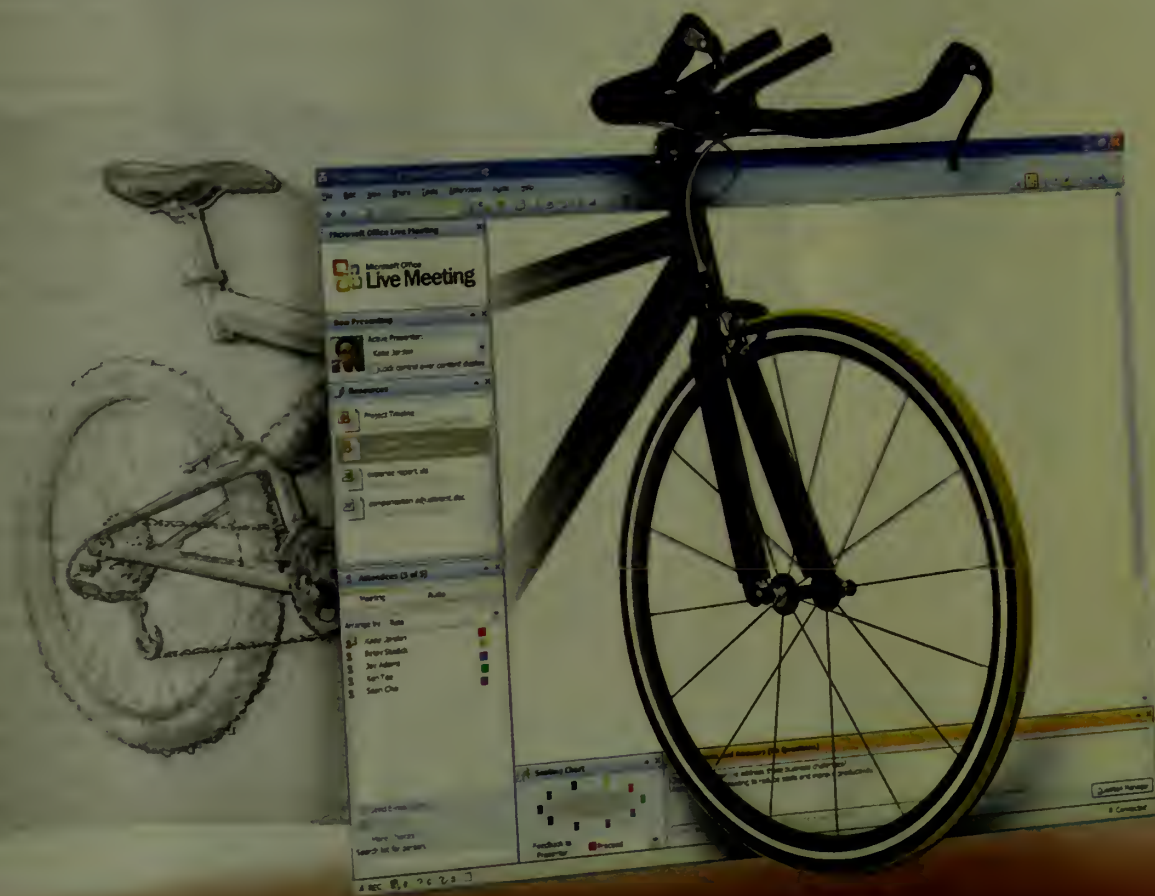
BUT THE VAST MAJORITY of companies continue to partially replenish executive option stockpiles. In 2004, for example, Richard D. Fairbank of Capital One Financial Corp. exercised more than a million options for a take-home total of \$56.1 million—and the board granted him 566,000 new options with a value of more than \$25 million. With more than 11 million options worth \$560 million in his stockpile, Fairbank can continue making withdrawals and deposits at that rate almost indefinitely. Fairbank's 2004 option grant was much larger than his 2003 grant, at a time when the company cut back on all option grants by nearly 60%. But as the board's compensation committee notes in the annual proxy statement, Fairbank did not receive a restricted stock grant in 2004, and he has waived his salary and bonus since 2002.

It will be a long time before execs burn off those option piles. For a hint of things to come, look at the option-exercising binge some CEOs went on in 2004. Lev Frankfort, CEO of trendy leather goods maker Coach Inc., exercised option worth \$84 million, on top of his \$58.1 million pay package. Coach Chief Financial Officer Michael F. Devine III says Frankfort earned every penny of his pay check: "He has created \$10 billion of shareholder value. I would take a \$10 billion return on a \$50 million investment any day." Still, critics of inflated CEO compensation will find plenty of ammunition for years to come. ■

—By Louis Lavelle in New York with bureau report

BusinessWeek online For an extensive report on the salaries, bonuses, and restricted stock and stock-option grants paid out to executives at 367 companies please go to www.businessweek.com/extras. Included is BusinessWeek's exclusive measurement of pay to performance. There, we rank each of the CEOs against others in their sector on the basis of compensation vs. return to shareholders.

It's how a sketch
becomes a sensation.



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MAKE IT FUN
Bonaminio in full
Jungle Jim mode



The Wizard Of Odd

Wackiness is grocer Jim Bonaminio's calling card. Will he keep Wal-Mart at bay?

JAMES O. BONAMINIO IS AN independent grocer with a capital "I." Today, if the mood strikes, Bonaminio might put on his wizard suit and roller-skate through his Jungle Jim's International Market performing "price magic." Or perhaps he'll go off "junking" for a few hours, returning with a ton or two of bargain-priced salvage that he eventually will incorporate into his sprawling, 280,000-square-foot supermarket in Fairfield,

Ohio—just like he did with the animatronic Robin Hood, the 40,000 blocks of wood extracted from highway guardrails, and the monorail recycled from an amusement-park ride.

Jungle Jim's might well be America's wackiest supermarket, but there is method to Bonaminio's madness. Instead of trying to beat the big chains at their price-squeezing game, Bonaminio has built a funhouse maze of a store north of Cincinnati that draws 50,000 shoppers a week from as far away as Indianapolis

and Lexington, Ky. "The Jungle" is not all fun and frivolity; its other defining trait is a huge selection of specialty foods from 70 countries. Sales totaled \$63.5 million in 2004, up from \$29.8 million in 1995—not bad for a college dropout who got his start in 1971 selling produce from a roadside stand. (Bonaminio says he turned a profit, but he won't disclose numbers.)

Jungle Jim's is as unique as a fingerprint, but it typifies retailing today in one respect: Its future is threatened by the relentless expansion of Wal-Mart Stores Inc. "People say, 'don't worry about Wal-Mart, you are unique.' Bullshit!" declares Bonaminio, a physically imposing 55-year-old with the lantern jaw of a comic-book superhero. "Independents are different, man; you can't ever let your guard down."

Wal-Mart has been slow to move into Cincinnati, in part because the city is home to Kroger Co., the largest U.S. supermarket chain. Last September, though, the discount store opened the first of what is expected to be about 15 megastores ringing Cincinnati. "I see Wal-Mart going from nothing to a 25% to 30% market share in four years," says David B. Birdsall, the Midwestern development chief of Regency Centers Corp., which owns a dozen shopping centers in greater Cincinnati, including one that is anchored by that just-completed Wal-Mart Supercenter.

SLOWING GROWTH

KROGER, MEIJER, Bigg's, and Cincinnati's other established grocers are about two years into a fierce struggle to try to add market share before Wal-Mart starts taking it away. Jungle Jim's dual emphasis on shopping-as-entertainment and specialty foods has insulated it from the price wars, but only to a degree. While Bonaminio makes most of his profit on high-margin specialty foods, he derives the bulk of his revenue from the same staples that every supermarket offers. Jungle Jim's growth has slowed markedly of late. Revenues have risen by 3.8% a

on average since 2002, compared with 11.4% from 1995 through 2001. The looming prospect of being sandwiched between two Wal-Mart Supercenters about 10 miles apart has roused Bonaminio to bold action. He is risking much of the profit he has accumulated on a \$10 million project to transform his store into a retail campus he calls "Foodieland." On Apr. 1, Bonaminio signed a letter of intent to open a second store. The 75,000 sq. ft. supermarket—tentatively named Baby Jungle—will be a 10-minute drive from the Fairfield store, moving Bonaminio close to the heart of Cincinnati.

Jungle Jim's has prospered to date not because of its location but despite it, in defiance of the first rule of retailing. The store is four miles from the nearest major highway, and a long stretch of traffic light separates it from Cincinnati proper. Even so, Bonaminio never seriously considered relocating even as his business began to expand.

His store is an amalgam of a dozen buildings constructed one after the other and joined together under one very convoluted roof. Built largely of recycled materials, Jungle Jim's is filled with novel design touches that Bonaminio delights in showing off: the antique fire engine resting atop a case holding 1,200 kinds of hot sauce; the mint-condition 1919 Boar's head truck in the deli section; the faux ortopottery doors that open into spacious storerooms; and on and on. Bonaminio put his Foodieland plan in motion a few years ago, and it is about

half realized. Next to the store he recently built a two-story "events center" for tastings, televised cooking demonstrations, and food and wine festivals. Within the new building is a large space that Bonaminio hopes to let to a restaurant operator. He's also looking to lure a hotel chain to his 71-acre property. "There are golf destinations all over America where you fly in and spend the weekend,"

Bonaminio says. "That's what I'm trying to do with Foodieland—create a campus with things for foodies to do when they're not shopping the store."

Even as Bonaminio hopes to create a more tempting destination for gourmet and ethnic shoppers, he also is trying to make Jungle Jim's the kind of place where locals will stop in to buy a loaf of bread

on their way home from work. Recently he moved his vast beer and wine selection from the front of the store into a new wing. This in turn freed the prime space in the store's center to be remodeled into what is essentially a conventional supermarket within a sprawling specialty store. Here, Bonaminio has collected in one place the everyday items formerly scattered through the rear of the store.

PLANTS, STAMPS, LATTE

BONAMINIO ALSO IS counting on the allure of one-stop shopping to ring the cash register. He has added a garden center outside the front entrance and leased space just inside it to a U.S. Post Office, a Fifth Third Bank branch, a Starbucks, and a pharmacy. Bonaminio just broke

ground on a shopping center next to the Jungle with room for a dozen restaurants and stores. Most of its 65,000 square feet already have been leased. "Such a huge number of people come through Jungle Jim's that if we just pick off 10% of them, we will make money hand over fist," says Brian Gillan, CEO of Buck\$ Dollar Stores, a small Cincinnati chain.

Foodieland's most distinctive feature—a two-mile monorail—will connect the far reaches of Jungle Jim's parking lot to various entrances when it begins operating in 2006. Bonaminio picked up eight trains from an area amusement park for just \$1 in 1998 but has spent \$1 million upgrading them and installing track. Part of what finally persuaded him to open a second store was the chance to adapt an old machine-tool warehouse for retail use. With the building comes a secondhand treasure to rival the monorail: a 25-ton crane. It's staying.

The consensus in Cincinnati retailing and real estate circles is that Wal-Mart's inevitable market share gains are unlikely to come at Bonaminio's expense. "Jungle seems wacky on the outside, but he has a consumer brilliance about him," says Robert Smyjunas Jr., president of Cincinnati developer Vandercar Holdings Inc., which has been trying for years to entice Bonaminio into one of its projects. "He really understands his market."

For his part, Bonaminio is taking nothing for granted. "Nobody's doing what I'm doing, and I don't know if I'm going to be able to do it," Bonaminio says. "Ask me in a year." Whatever happens, America's most independent grocer no doubt will continue to do his own thing—and have fun doing it. ■

—By Anthony Bianco in Fairfield, Ohio

Next up: Luring a hotel to the 71-acre Jungle Jim's property

BIO

James "Jungle Jim" Bonaminio

BORN: June 28, 1949, Lorain, Ohio.

EDUCATION: Attended Miami University (Ohio) but did not graduate.

CURRENT POSITION: Proprietor of Jungle Jim's International Market in Fairfield, Ohio.

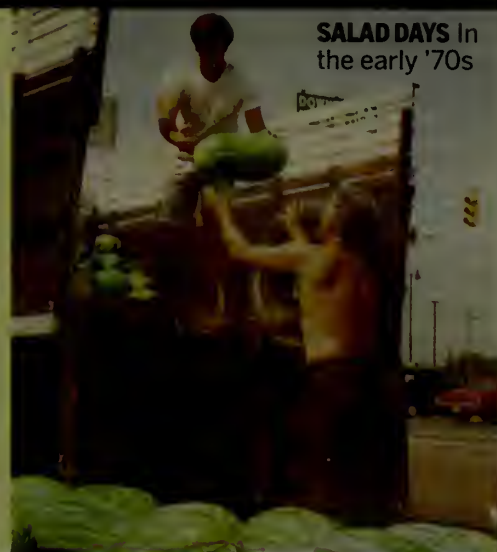
EARLY DAYS: Got his start running a produce stand while living in an abandoned gas station. A produce supplier dubbed him "Jungle Jim" because he always dressed in shorts.

ON COMPETING WITH

WAL-MART: "Because Wal-Mart is so definite on who they are, they really open a wide niche for a business like mine."

FAMILY: Married with two sons, Jim and Chris, and a daughter, Dana.

HOBBIES: "I love to go junkin'." Last major purchase: a half-dozen tractor-trailer loads of store furnishings, including eight-foot-long sheets of acrylic.



The Busiest Broker on Earth

Fidelity's Internet operation has turned up the pressure on Schwab and other rivals

FIDELITY INVESTMENTS, the privately held mutual-fund giant, has quietly built one of the biggest brokerages on the planet. Operating almost entirely online, it has added more than 1 million retail accounts in the past two years, giving it 9.9 million customers at the end of 2004. That's 40% more than Charles Schwab Corp. and 10% more than even Merrill Lynch & Co. Fidelity ended the year with \$1.13 trillion of assets in its customers' brokerage accounts, muscling aside Schwab for the first time and closing in on Merrill's \$1.36 trillion. "Fidelity was always big, but they were viewed as a sleeping giant," says Richard H. Repetto, an analyst at securities firm Sandler O'Neill & Partners. "Now they're seen as in the game."

Fidelity's renewed assault on the industry's leaders began in October, 2002, when it tapped a 12-year company veteran, Ellyn A. McColgan, to run the brokerage unit. She trimmed costs, spent millions to upgrade the Web site for retail customers, and launched a series of ruthless price cuts. Fidelity now charges customers who make 120 trades a year just \$8 a pop, vs. \$14 for customers making 240 trades when she took over. "They spent a lot of money to upgrade their technology and improve customer service without drawing attention," says Matt Snowling, an analyst at Friedman, Billings, Ramsey Group Inc. "Not until all that was in place did they come with the price cuts, the media campaign, the conference calls."

The onslaught has other online brokers scrambling. In just two years, Schwab has lost almost 10% of its brokerage accounts,

and E*trade Financial Corp. 20% of its accounts. That has forced both to cut staff and close offices. The price cuts have been so harsh—Schwab's average commission per trade fell 43% from 2002 to 2004 and continues to fall this year—that some analysts say online brokerages are rapidly becoming unprofitable. Only firms that can use trading to attract customers for other services will survive, says Tom Watson of Forrester Research Inc.

TRADING UP

Fidelity's brokerage handles more trades than Schwab...



...and trails only Merrill in total brokerage assets...



...but holds far fewer assets from financial advisers than Schwab



Data: The firms

Schwab says it more than made up for the lower commissions with higher revenue from managing funds and providing banking and advisory services. Its fourth-quarter operating profit margin reached 15.5%—the highest in almost five years. "We have our own punch list of what we think are great ideas, [rather than responding to what the competition does]," says Michelle M. Swenson, senior vice-president in the advisory brokerage unit. Meanwhile, Merrill spokesman Eric Hendrickson says the firm is not a discount broker and it hasn't cut its commissions. Unlike the online firms, Merrill has 14,000 brokers who provide advice and other services.

LUCRATIVE AREA

FOR ALL OF MCCOLGAN'S success, Schwab has been unable to break Schwab's grip on the lucrative business of catering to independent financial advisers. In the past two years, Schwab has actually widened its lead among advisers, who place hundreds of millions in client assets with brokerages. But McColgan senses an opening as Schwab tries to steer more customers to its in-house advisers without alienating the thousands of outside advisers it also serves.

Schwab also has competed fiercely for retail customers, especially since founding Charles R. "Chuck" Schwab returned as chief executive last summer. After Schwab cut its trading commissions last year both it and Fidelity took market share from smaller online competitors. "Just because Schwab has a chance to grow doesn't mean it has to come out of [Fidelity Chairman] Ned Johnson's hide," says fund manager Ron Baron, who bought more than 1 million shares of Schwab in the fourth quarter and owns almost 15 million at yearend.

Fidelity won't disclose its brokerage unit's results, but it is probably more profitable than Schwab's, analysts say. That's because almost half of Fidelity's brokerage assets are invested in Fidelity funds as opposed to the one-eighth that are managed in-house at Schwab. Fidelity makes about 0.7% to 0.8% on each dollar of brokerage assets, compared with only 0.2% to 0.3% at Schwab, says Christopher Roame, managing principal at Tiburon Strategic Advisors, a consulting firm in California. "Fidelity is ragingly more profitable." With so much money at Fidelity sitting in Fidelity funds, he adds, the firm "is already ringing the registers."

As a private firm that doesn't need to hit quarterly earnings numbers expected by Wall Street, Fidelity can afford to keep

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to the pressure on Schwab and others with little concern for the up-front costs. Last year it spent \$700 million on technology alone at the brokerage unit. "It's somewhat scary for everyone else," says analyst Snowling. "[Fidelity] doesn't have to play by the same rules."

Before joining Boston-based Fidelity in 1990, the 51-year-old McColgan earned her stripes on Wall Street. After getting an MBA at Harvard Business School in 1983, she worked as an assistant to Jeffrey B. Lane, then chief operating officer at Pearson American Express and now co-chairman of Lehman Brothers Inc.

"She handled a big bureaucracy exceedingly well, and that's always a sign of someone going places," Lane recalls. McColgan made her name at Fidelity when she turned around a money-losing unit that ran retirement plans for non-profits, almost quadrupling its assets, to \$75 billion, from 1996 to 2000. When she took over the brokerage operation in 2002 she had never worked with retail customers. At the time, the bear market was in its third year, and the unit was in a slump. "Fidelity's pricing was uncompetitive, their [online] platform had gotten outdated, and they were losing market

share," says Snowling. "Their trading volumes were in the gutter."

Most of McColgan's turnaround strategy came right from the playbook of Edward C. "Ned" Johnson III, who has run Fidelity since 1972: Spend and spend to improve technology and customer service, and emphasize market share first and profits later. To attract frequent traders, McColgan purchased Wealth-Lab, a software program used to develop trading strategies, and added a dozen outside research sources to its Web site. The site not only offers reports from firms such as Lehman and Prudential Equity Group but also rates how accurate their past stock picks have been. McColgan also began adding branches around the country, opening 10 last year, including six within a half-mile of a Schwab office.

She also did something uncharacteristic of Fidelity: She spent more than \$500 million on an acquisition spree. That beefed up its brokerage services for institutions and helped the firm gain ground on Bank of New York's Pershing, the market leader in terms of clients. Fidelity has vaulted over Goldman Sachs and Bear Stearns by adding clients such as Northern Trust, Washington Mutual, and Bank of America.

"A BURST OF ENERGY"

NOW MCCOLGAN IS focusing on Fidelity's failure to make much headway with financial advisers. In January she decided to replace the longtime head of the advisory business, Jay Lanigan, a 25-year Fidelity veteran. Over the previous two years his operation had doubled the amount of assets it handled, to \$137 billion. But Schwab had collected much

Will new software lure more advisory business?

more and now boasts \$348 billion. Lanigan declined to comment. McColgan says she's looking to hire someone who will "bring a burst of energy" and close the "big fat lead" Schwab has built up. To catch Schwab, Fidelity will spend "a lot more" to boost its service for advisers, she adds. "We shoot for No. 1." Just last week, Fidelity introduced Web software for advisers that combines customer portfolio and contact information with trading and planning tools.

The battle to win over financial advisers and attract the assets of their clients is crucial to staying on top in the brokerage

an edge by, say, trading more heavily at the opening and close, when volume is high, and less when it slows down around lunchtime. And they can be customized, for example, to sell stock stealthily over several weeks if a manager holds a 3% position in a particular stock and wants to cut it to 1%. Not only is algorithmic trading in principle more secure than using a human broker but it also costs less than a penny a share to trade electronically, vs. 6¢ for full-service trades, which include research.

Wall Street sees algorithms as a way to recapture the large volume of commission revenues lost to rival electronic exchanges. In addition, banks and brokers are selling new services that allow money managers to test the performance of the trades before and after they are executed to help managers improve their trading techniques. In the past 18 months or so, every major broker (and a handful of independent software vendors) have spent millions ramping up the business, including Merrill Lynch, Citigroup, JPMorgan, and HSBC. Others have bought into the business. Last year, Bank of New York Co. and Piper Jaffray & Co., respectively, bought algorithmic specialists Sonic Financial Technologies LLC and Vie Securities LLC.

BIG SHARE

ALGORITHMS ARE a step up from the more familiar program trading, which institutions for years have used to buy or sell bundles of 15 or more stocks worth a combined \$1 million. Algorithms handle trades in individual stocks, and the exchanges don't ban their use when trading becomes extremely volatile, as they have done with program trades since the 1987 market meltdown. As the use of algorithms moves from hedge funds and Wall Street's trading desks to mutu-

al- and pension-fund managers, it will account for more than 40% of total U.S. equities trading on all markets by 2008, up from about 25% today, according to Boston-based researcher Aite Group.

But as with all Wall Street feeding frenzies, there are dangers. Some critics say that when less experienced hedge- or mutual-fund traders use the software they've bought from Wall Street, they inadvertently expose their trades. How? Canny traders, mainly those who trade on behalf of big banks and brokerages with the firms' capital, may be able to identify patterns of algorithms as they get executed. "Algorithms can be very predictable,"

By 2008, 40% of U.S. equity trades will be done by algorithms

details of client orders even circulate outside their algorithmic groups—or that algorithmic patterns can be traced. "We live or die by how well we trade," says Dan Mathisson, Credit Suisse First Boston's global head of advanced executive services. "A significant deterioration in performance would kill us; there are no information leakages."

JPMorgan, the bank's own traders are separated physically from the algorithmic unit, and the computer systems are shared either, according to Emily Portner, chief operating officer of JPMorgan's equities Americas business.

Some critics simply question Wall Street's wisdom in investing large sums in algorithms. Says Randy L. Grossman, capital markets research manager at Financial Insights in Framingham, Mass. "Many firms have spent millions of dollars to develop algorithmic capabilities. Many, we believe, have not done a realistic return-on-investment analysis of this tool."

NASD INQUIRY

ALL THE SAME, some of the bigger firms are looking into ways to use algorithms more widely. They're mulling systems to trade futures, currencies, international stocks, or baskets of stocks. Already, algorithms are having a huge impact on trader productivity. Banc of America Securities LLC, for example, has slashed the number of its traders by almost half in the past two years while increasing its overall equity trading volume by 160%. Today about half its trades are made with algorithms, up from none two years ago.

Regulators are aware of the potential for algorithmic trading problems. The NASD, with the blessing of the Securities & Exchange Commission, is collecting documents and interviewing traders at several major brokerages to learn more about the programs and their potential for abuse. Unlike ongoing probes of alleged front-running at the NYSE and specialist firms, the inquiries on algorithms aren't full-blown enforcement investigations—and won't be unless they turn up evidence that brokers are abusing the computerized orders. For now, at least money managers seem quite happy to embrace algorithms to ease their trading headaches—and cut their costs. ■

—By Mara Der Hovanesian in New York

Look, Ma, No Hands!

Sophisticated computer models now execute more than half of all stock trading. Here's a guide to the main types:

ALGORITHMIC TRADING

Stealth programs based on price and volume patterns that disguise trading tactics by splitting up big buy or sell orders of 5,000 or more shares of a single stock into bite sizes. Now used by pension and mutual funds.

BLACK BOXES

Proprietary systems that use short-term pricing discrepancies. For example, used to buy one stock while shorting another when the stocks are trading outside their normal patterns because of unexpected news. A hedge fund favorite.

PROGRAM TRADING

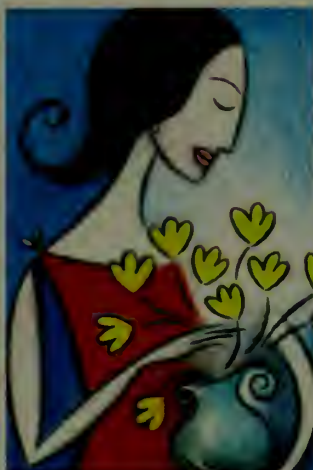
Programs that buy or sell baskets of 15 or more NYSE stocks with a total value of at least \$1 million. Curbed when trading is very volatile. Mostly used by index funds.

says Steve Brain, head of algorithmic trading at electronic communications network (ECN) Instinet Group Inc.

Coupling that with a few phone calls to chat about order flows and some traders may be able to piece together enough information to "front-run," or profit by trading ahead of the customer. "There are people out there who seek to reverse-engineer algorithms," says J. Mark Enriquez, chairman of Pulse Trading Inc., which operates an aggregation service that can tap into all available ECNs and alternative exchanges. "The larger firms will swear on a stack of Bibles that there is no info leakage...[but] given the history on Wall Street, there is a potential for someone to figure out how to access" details about algorithmic trades. The chief executive of a leading alternative exchange, who spoke on the condition of anonymity, says: "These tools are in effect a Trojan horse."

Many Wall Street firms strongly deny that

Data: BusinessWeek



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INNOVATIONS

Of bird flu
and brass urns

► British scientists have taken a step toward creating a vaccine against avian flu by making the virus safe enough to handle. John Wood of Britain's National Institute for Biological Standards & Control says that his team used "reverse genetics" to remove the deadliest segments from the genome of the H5N1 virus, which is rampant in Asia's bird populations and threatens to cross over to humans. He has distributed his defanged virus to vaccine makers who hope to avoid a global pandemic.



►► So much for modern technology: According to a report at an April microbiology meeting in Edinburgh, drinking water in rural India and elsewhere is safer if it's kept in traditional brass containers like the one above rather than in modern ones. Scientists from Northumbria University in Britain and Panjab University in India found that bacteria in contaminated water were completely wiped out after two days of storage in brass containers, but not in ceramic or plastic. They said minute traces of copper from the brass, too small to be toxic to humans, dissolved into the water and acted as a disinfectant. —Catherine Arnst



SPACE TRAVEL NEXT BEST THING TO A STAIRWAY TO THE STARS

SPURRED BY THE X Prize Foundation's \$10 million purse for the first private space plane, two dozen teams invested at least \$100 million trying to win the kitty. Now, NASA hopes to unleash a similar 10-to-1 spending spree for the ultimate method of getting off the Earth: a space elevator.

Long familiar to science fiction fans, the elevator would ferry astronauts and their craft beyond the earth's gravity by climbing a cable made of strong and light carbon nanotubes at least 22,000 miles up to

geosynchronous orbit. Electricity for the motors would be beamed up by laser or microwaves, since a copper cable would weigh too much.

For this year's NASA Centennial Challenges, the strongest nanotube ribbon will be rewarded with \$50,000. The same sum will go to whichever model of an energy-beam-powered robot can carry the heaviest load while climbing a 50-meter cable. Next year, NASA will boost the prizes to \$100,000. Building the real thing would probably cost \$10 billion over 15 years.

ENVIRONMENT AS THE WORLD TURNS—FOR THE WORSE

MARCH WENT OUT with a roar of warnings, with three separate studies painting a bleak environmental picture. The weightiest was the U.N.'s Millennium Ecosystem Assessment Synthesis Report. The result of four years of work by 1,300 experts in 95 countries, it warns that

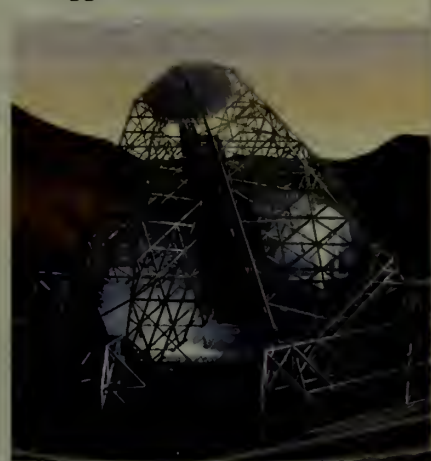
without radical policy changes by business and government, the world will see fishing grounds turn into "dead zones" and abrupt regional-climate changes. The Climate Monitoring & Diagnostics Laboratory on Mauna Loa on Hawaii notes that levels of carbon dioxide rose last year for the 47th consecutive year. And new computer modeling by Colorado's National Center for Atmospheric Research predicts the atmosphere will keep warming for decades.

ASTRONOMY A TELESCOPE AS BIG AS THE RITZ

SO FAR, SOME 130 stars are known to have giant, Neptune-size planets—and computer models indicate that perhaps half of them might also have Earth-like planets capable of supporting life. While no existing telescope can see them, an "eye" with a 100-meter-diameter mirror could. That's 10 times the size of today's biggest telescopes.

One concept for such a monster telescope, shown below, was unveiled at the early-April meeting of Britain's Royal Astronomical Society by Isobel Hook, an Oxford University astronomer and co-leader of Opticon, Europe's effort to develop an extremely large telescope (ELT).

Since just its mirror would be bigger than a football



field, the entire ELT would dwarf a sports stadium. So would its price: \$1.28 billion is the rough estimate, says Hook. Assuming funding can be found—and the European Commission has kicked in \$10.3 million to start the engineering design—Hook figures building the ELT would take at least a decade.

The Coming Chip Revolution

Facing the limits of silicon, scientists are turning to carbon nanotubes

IN A DIMLY LIT LAB IN YORKTOWN Heights, N.Y., the workbenches are crowded with scanning-tunneling microscopes, atomic force probes, and an assortment of other tools used to render the molecular world visible. There, at IBM's Thomas J. Watson Research Center, Phaeton Avouris and his team are using these instruments to conquer the Everest of nanotechnology: They're learning how to weave wisps of carbon, atom by atom, into working transistors.

Avouris' aim is to outrun a ticking clock. Since the dawn of the semiconductor industry a half-century ago, computer companies have depended on chipmakers to keep Moore's Law on track, doubling the speed of their devices every 18 months. The chipmakers achieved this magic by packing transistors more closely together on ever-shrinking flecks of silicon. Tinier transistors run faster. But the chips also run hotter, and they become much more complicated to produce. As chip features shrink from 90 nanometers today to-

ward 20 nm or 10 nm over the next decade, the burdens of heat, cost, and unruly physics could render silicon useless. If the industry doesn't find an alternative, Moore's Law will hit a brick wall.

EFFICIENT REPLACEMENT

THE PROBLEMS ARE already taking a toll. Today's fastest PC chips run hot enough to cook an egg. If unchecked, the increase in heat is on track to hit metal-melting temperatures by decade's end. That not only wastes power—as much as half the power consumed by today's fastest processors may be lost as heat—but can also slow down or even damage a chip. And due to the increasing complexity of the fabrication process, the price tag of a single semiconductor factory, or fab, could hit \$10 billion by the decade's end, up from \$2 billion today. "Chipmakers have to get away from multibillion-dollar fabs," says Sam Brauer, a principal at Nanotech Plus LLC, a market consultant in Stamford, Conn. "It's their Holy Grail."

At IBM, Infineon, NEC, and a clutch of startups, the leading candidate to replace

silicon is the ethereal carbon nanotube. This tiny molecule—100,000 lined up side by side are about as thick as a human hair—promises to make circuits faster, less power-hungry, and more densely packed than anything possible today. And they could vastly simplify the way chips are made.

Even though such transistors are still in their infancy, says IBM's Avouris, "Carbon nanotubes can get around most of the problems that doom very small silicon devices." In the lab, he has backed that statement up. It took him four years to assemble his current, third-generation prototype of a carbon nanotube transistor, but in the end, the device can carry up to 1,000 times the current of the copper wires used in today's silicon chips, making it vastly more efficient.

The nanotubes themselves are deceptively simple. Joined in superstrong hexagonal bonds, carbon atoms arrange themselves in a cylinder, like a coil of chicken wire. By changing the geometry of the tube's honeycomb of atoms, researchers can tune them to resist or conduct electricity, which is one reason they can carry very high currents while emitting little heat. "Mixing together nanotubes with different electrical properties could simplify the design of future chips," says Paolo A. Gargini, chairman of the International Technology Roadmap for Semiconductors, an industry planning consortium, and Intel Corp.'s director of technology strategy. It would eliminate many of the exotic chemicals and processes now used to make chips.

The virtues of nanotubes go beyond electricity. In addition to being excellent conductors of heat, the tubes are 10 times stronger than steel and are resistant to radiation. This matters because as chips get smaller, they are becoming more vulnerable to damage from high-energy solar pa-

How Small Is Small?

Silicon chips have powered the computer age, thanks to ever-shrinking electronic circuits. But the scaling down can only continue a few more steps. After that, industry hopes are riding on carbon nanotubes:

Width, nanometers
20,000-150,000

Human hair has long been used to explain the width of semiconductors' smallest features.



7,000

A dot of 50 red blood cells might just be visible to the human eye.



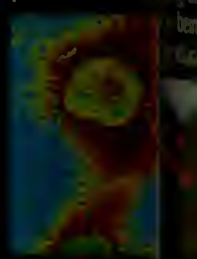
5,000

Circuit lines on Intel's 286—the first multipurpose processor for personal computers—were roughly 55 times larger than the lines on today's microprocessors.



150

Thousands of viruses can be packed in a cube the size of a single virus.



es. So, long before they replace transistors as the brains of chips, says Craig Under, Advanced Micro Devices' vice-president for technical development, carbon nanotubes are likely to be mixed in as part of the chip's structural layer.

TRICKY PHYSICS

ALL THEIR PROMISE, nanotubes face huge challenges going from lab to fab. Current production techniques yield a few of more than 30 varieties of nanotubes, points out Tim Gierke, a nanotechnology researcher at DuPont. Some layers, such as Houston's Carbon Nanotechnologies Inc., are striving to refine their production recipes to make more of the most desirable variety. DuPont, meanwhile, is working on tools to sort tubes by their size and electrical properties.

Even with a reliable supply of tubes, scaling up production to supply a vast global industry will take years. Researchers at both IBM and Infineon have built nanotube transistors with electrical properties far superior to those of silicon. But today's most powerful processors have a billion transistors each. Scientists have no idea how to match the enormous efficiency of today's manufacturing methods, says Gargini.

What nobody disputes is that the existing recipe for making silicon chips is already running into trouble. Circuits work little like garden hoses: When you make those narrower, you have to increase the water pressure to get the same volume through it. Likewise, chipmakers have had to boost the voltage on the chips so that more current can pass through smaller circuit lines. At the same time, chips are getting "leakier," like a hose riddled with pinpricks. There are simply fewer atoms in the chips' insulation layers to keep electrons from tunneling through.

Other problems are surfacing, too.

Once-inconsequential variations among the millions of transistors on a chip begin to matter at smaller dimensions. On a Pentium 3, circa 2003, with circuit lines a generous 180 nanometers wide, a 20-nm defect was nothing to worry about. But at today's 90-nm standard, such a flaw can render a transistor useless. "The hell of nanoscale physics" is how Hugo De Man, a senior researcher at Belgium's Interuniversity Microelectronics Center, describes the fast-multiplying challenges chipmakers face.

What's more, the tricky physics is driving up the cost for next-generation plants. Infineon Technologies' new memory-chip factory in Richmond, Va., showcases the staggering complexity—and expense—necessary to stay competitive. Roughly four football fields in size, the \$2 billion facility is part of an elite club of chip plants that, on a per-acre basis, rank among the most costly factories ever built.

Inside this hangar-like factory, machines build machines. Untouched by human hands for weeks, chips-in-progress pass through hundreds of processes, moving to and from dozens of million-dollar machines via a pint-size robotic monorail. The chips will travel miles in this plant before emerging, after two to three months of processing, as a commodity RAM chip, ready for your next desktop.

Laborious as this process is, it will be hard to supplant. At the end of the day, chip quality is high. And there are ways to get around heat, such as designing better "architectures"—the way transistors are



Avouris' IBM team took four years to make a carbon transistor

organized on the chip. AMD, IBM, Intel, and others are exploring "multicore" processors that multiply the number of brains on a chip from one to two, and in time, to four or more.

Whether nanotube-based chips are 10 years away or 20, experts agree the transition will be incremental. First they expect to see hybrid silicon-nanotube designs—an approach that suits the industry's titans. With 50 years of experience in silicon, billions invested in R&D, and countless more sunk into silicon-based factory processes, chipmakers prefer enhancements to the current model, not disruptive substitutes. "The shift has to be evolutionary," says George M. Scalise, president

of the Semiconductor Industry Assn.

Silicon-carbon hybrids are part of that trend. Nantero Inc., a Woburn (Mass.)-based startup, is working with LSI Logic Corp. to make nanotube RAM using existing silicon processes. Nanotube-based memory, says Nantero CEO Greg Schmergel, is as fast and dense as the RAM now used in computers but can maintain data without power, like the more costly flash memory used in digital cameras. "Imagine booting up your PC instantly or replacing your hard drive with much faster RAM," says Schmergel.

Nantero is hoping for a major performance leap, but others are skeptical, noting that it can take 10 years to perfect even small steps forward in existing chip technologies. So for the next big leap, the industry is taking a long running start. ■

—By Adam Aston in New York

10-15	7	2	1.5	0.1
When chip features hit this scale, sometime around 2015, a combination of heat and tricky quantum effects will make it difficult or impossible to employ silicon as a substrate.	Carbon nanotube transistors like the one in this simulation by Infineon perform well in lab tests.	Research into DNA is shedding light on how to manipulate nanotubes.	Diameter of a single carbon nanotube.	Hydrogen atoms reside at the far extreme of nanoscale engineering. Already, scientists can corral individual atoms into simple functional structures.

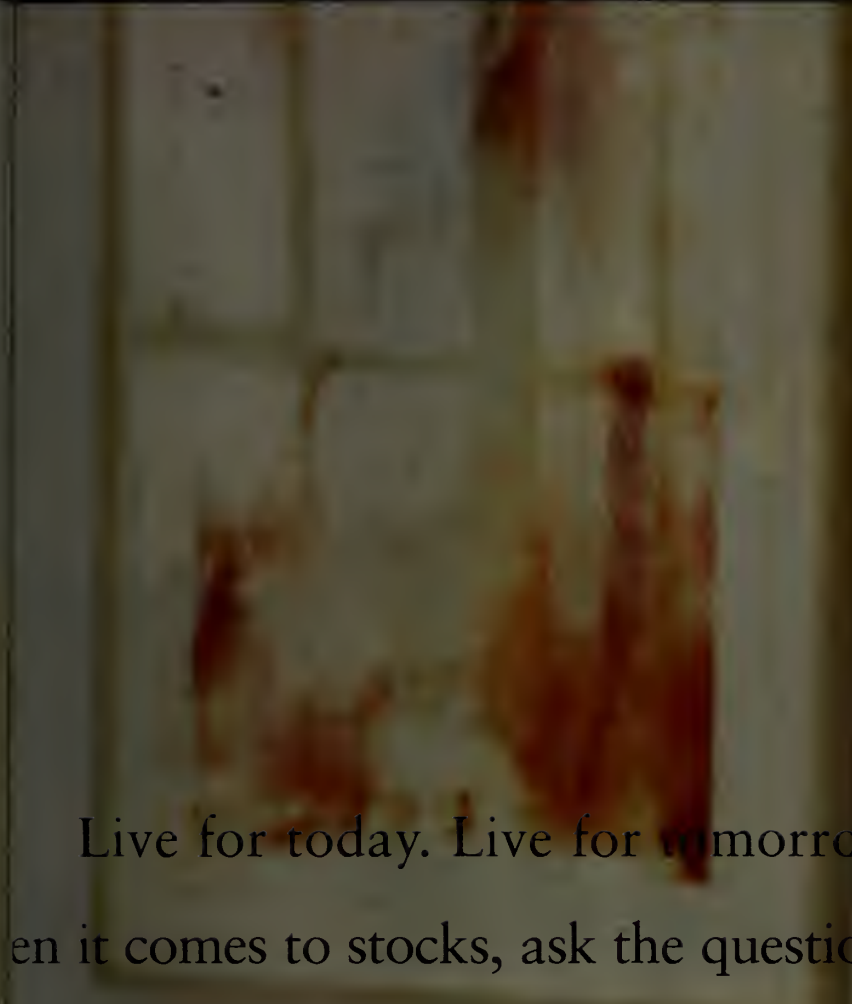
DATA: IBM, Infineon, The Royal Academy of Engineering (UK), The International Roadmap for Semiconductors, BW.



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HELPING HAND
Hayward adds
veggies to me
the Hinrichs fa

Come Home to Your Own Chef

For busy families, it's worth it to let a pro do the cooking. **BY JANE BLACK**

IN THE WEEKS LEADING UP to Apr. 15, San Diego tax adviser Tina Huston simply doesn't have time to cook. "It's difficult enough working 40 hours a week and preparing dinner each night. It is impossible working 60 hours a week during tax season," she says. Still, Huston is committed to giving her diabetic husband, Jeff, and their two young daughters healthful, low-carb meals. So last year she hired personal chef Beckette Williams to come to her house once a month to prepare and stock the freezer with entrées such as tequila-and-lime chick-

en and beef Stroganoff. Each meal is labeled with heating instructions and nutritional information so Jeff can adjust his insulin pump accordingly. Huston quickly got hooked: "We kept the service even after tax season. Instead of spending time in the kitchen cooking and cleaning, we have free time in the evenings with our kids."

For most of us, the words "personal chef" conjure images of a celebrity entourage. But families like the Hustons are typical clients. According to the American

sonal Chef Institute & Assn., there are about 9,000 personal chefs in the U.S. serving 72,000 clients—families with two working parents, busy single professionals, people with restricted diets, and, increasingly, senior citizens who no longer cook for themselves.

Over the next five years, some 10,000 clients of 20,000 chefs are expected to pay \$1.2 billion for in-home meals. "Most clients are middle-class folks who are too busy to cook and are tired of eating take-out or in restaurants where the food is loaded with fat and preservatives," says Candy Wallace, executive director of the American Personal Chef Institute & Assn. "Our message is that you don't have to be Oprah to hire a personal chef."

ME TIME
Enjoying a
meal cooked
by Hayward

Begin by finding a personal chef in your local telephone listings or by visiting the chef association's Web site, personalchef.com, which

dancer, Hinrichs is determined that her sons, 8 and 2, learn to resist the persistent call of fatty, packaged foods in favor of fresh fish and fresh vegetables. "Whatever works for them works for me," says Hayward. "That's what a personal chef service is about."

PACKAGE DEALS

THE NEXT STEP IS deciding how many meals you need. Although prices and packages vary, most chefs offer what's known as a "five by four"—four portions of five entrées and side dishes. This will provide 20 dinner-size servings. Personal chefs also offer a "five by two"—two portions of five entrées. But this is usually not cost-effective. A typical five-by-four costs between \$350 and \$400, including groceries. That's \$17.50 to \$20 per person, more than a family-style eatery but less than an upscale restaurant. A five-by-two—half as much food—costs only about 20% less, \$285 to \$325, or around \$30 a person.

food you're eating, ask if the chef can provide a nutritional breakdown for each meal. Chefs can offer this information by feeding the ingredients of a menu into a special computer program that then prints out a nutritional label. It's similar to what you'd see on the side of a cereal box.

Many personal chefs are retired restaurateurs, but hundreds of home cooks have been drawn to the business by the flexible hours and growing demand. A culinary school education, restaurant training, or professional seminars are desirable but not essential to finding a qualified personal chef.

Just make sure anyone you are thinking of hiring provides references from satisfied customers. You should also try to taste the food. If the person won't bring samples to the interview, as a

caterer often will, pay to have him or her prepare one or two representative meals before you make a larger commitment.

Since the chef will usually be cooking in your home, check that the person is licensed and insured against a fire breaking out in your kitchen or damage to appliances. All chefs affiliated with the American Personal Chef Institute & Assn. are certified safe food-handlers. They also have valid municipal business licenses and carry general liability insurance of \$2 million.

Finally, think about what you'll do with all that time you're not shopping and cooking. "This service is [about] more than food," says Wallace. "It's about stress reduction and enhancing the quality of your life." Call it the taste of freedom. ■

What To Ask the Chef

■ What is your training: culinary school, professional seminars, or restaurant work?

■ Can you provide references along with a sample of your cooking?

■ Do you offer a nutritional breakdown of the menus you prepare?

■ Will it be less expensive if you charge a flat fee rather than billing me for groceries separately?

■ If I need you more than I expected, can I reserve you on short notice?

■ How much advance notice do you require if I have to cancel? Is there a cancellation fee?



offers a state-by-state directory. Set up a meeting to discuss your food likes and dislikes, allergies, and any special dietary requirements.

Be as fussy as you like. In San Diego, chef Williams leaves out garlic, onions, and mushrooms for one client and provides a special brand of low-fat sour cream for another. Anne Hayward, who is Premier Concierge of Columbus, Ohio, adds three times the number of vegetables to her beef stew for 36-year-old mother Felicia Hinrichs. An ex-ballet

To get more bang for the buck, some families request six entrées in lieu of vegetable side dishes. After all, it's not hard to open a bag of prewashed salad or steam some broccoli. Clients who want all organic meat and vegetables can expect to pay a surcharge. Hinrichs claims to save money with a personal chef even over eating at home, because she doesn't waste money on food she buys but never cooks.

If you're concerned about fat, carbs, calories, or any other component of the

Now That's a Liquid Investment

From filter makers to utilities, water stocks are attracting investors. **BY AARON PRESSMAN**

OIL AND COPPER STOCKS are benefiting handily from booming commodity prices. But another substance even more precious is boosting a previously overlooked group of stocks. Savvy investors, including small-cap maven Chuck Royce, Fidelity Contrafund manager William Danoff, and hedge-fund manager Stanley Druckenmiller, have been accumulating water stocks for months. Water? That's right, good old H₂O, a gallon of which sells for more than an equal amount of gasoline, as some analysts who follow the sector are fond of noting.

A confluence of trends has led to increased interest in companies that make water treatment and filtration equipment, build water infrastructure such as pipelines and sewage treatment plants, or run water utilities. The several dozen stocks in the sector had a terrific run last year but have sold off in the first quarter, offering a more attractive entry point for long-term investors.

Spending on various water projects will be huge. The Environmental Protection Agency estimates it will cost \$500 billion over the next 20 years to maintain the country's water networks. The agency



is also cracking down on cities with water pollution problems, such as Atlanta, Cincinnati, and San Diego, and forcing them to upgrade their facilities. Clean water is an even bigger problem in China,

where the government is building treatment plants. The damage caused by December's tsunami will require the building of water infrastructure across other parts of Asia as well.

DIVERSIFICATION

THE BEST INVESTMENT strategy is to diversify among several kinds of water companies (table). Both Danoff and Druckenmiller own CUNO, which makes filters out of everything from glass and ceramics to cellulose. Such filters are used under kitchen sinks and in wineries and pharmaceutical companies. Recent new orders came in during its January quarter, and the company is forecasting a 15% rise in earnings this year.

Danoff and Druckenmiller have also bought Pentair, which gets two-thirds of its revenue from pumps and filter sales and is projecting 45% growth in earnings per share for 2005. And they both added Nalco Holding, a leading provider of water treatment chemicals that went public in November. The company is paying down debt and expects to increase cash flow at double-digit rates. Analysts who follow the sector note that defense contractor ITT Industries gets about 38% of its revenues and 45% of its operating income from its water-related businesses.

For value investors

looking for less pristine companies, one of Royce's holdings, Insituform Technologies, is out of favor because of an ill-fated foray into tunnel construction. Nonetheless, the company is benefiting from a growing number of sewer-repair projects, says Deborah Coy of Washington Research Group. Similarly, Tetra Tech is refocusing on water projects after getting into trouble building cellular-telephone towers. Last month the company announced a \$10 million loss, but Coy thinks that's the end of those woes. "They're coming back to the core things they do well," says Coy. "Earnings will recover this year." Calgon Carbon, a Royce holding which makes ultraviolet purification systems, is reorganizing, taking a write-off, and expects

Water Stocks: A Profit Surge Ahead?

COMPANY/SYMBOL	PRICE*	1-YR RETURN*	COMMENT
Aqua America WTR	\$24.62	14%	Utility showing earnings and dividend growth
Calgon Carbon CCC	8.37	12	Purifies water with ultraviolet light
CUNO CUNO	51.17	12	Makes filtration systems; earnings up 23%
Insituform INSU	14.55	-9	Sewer system builder hit by tunneling losses
Nalco NLC	18.88	10**	Using IPO money to pay down debt
Pentair PNR	38.77	30	Two-thirds of sales from water businesses
Tetra Tech TTEK	12.54	-43	Dumping wireless to focus on water

*Apr. 4 **Since Nov. 16, 2004 IPO

Data: Yahoo! Finance

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Some investors are looking at water utilities, too, since they don't face the same deregulatory pressures that affect power companies. "You can't deregulate water unless you figure out how to beam it from place to place," notes David

Schanzer at Janney Montgomery Scott.

The biggest publicly traded water utility is Aqua America, formerly known as Philadelphia Suburban but now operating in 13 states as far away as Texas and Missouri. Utilities typically don't grow much faster than the overall economy, but Aqua has been an active acquirer, buying

111 companies over the past five years. The company hiked its dividend 8% a year, the 14th increase in 13 years.

Investors buying now may have more to worry about on some of the runup in water-relevant equities. But the world's unquenchable thirst suggests that these stocks won't be running dry anytime soon. ■

Autos

Are You Sure This Isn't a Lexus?

The new Toyota Avalon sedan has surprising style—and power. **BY KATHLEEN KERWIN**



WELL-PRICED
The Avalon starts at \$26,890

AIMING TO OFFER THE best traditional American sedan on the market, Toyota succeeded in out-Buicking Buick when it introduced the Avalon in 1995. The car was smooth, quiet, roomy—and bland. This time around, Toyota has kicked up the excitement level. Forget Buick. The new 2005 Avalon brings a Lexus to mind.

The overhauled version no longer uses a Camry chassis, allowing it to stretch five inches longer to create a more spacious cabin. The 2005 model also boasts Toyota's new 3.5-liter, 280-horsepower, V6 engine for added power. Best of all, the car finally has some flair, with a more contemporary-looking exterior and a knock-

out of an instrument panel. At a starting price of \$26,890, the new base model costs just \$205 more than the outgoing version. Trick it out with all the luxury options, and you're pushing \$40,000. That might sound steep for a family sedan. But consider that the least expensive Lexus, the ES 300, starts just below \$33,000, without the space, power, and even some of the amenities of the comparably priced Avalon.

The first thing I noticed about the new Avalon is what wasn't there: a key. If the driver has the remote in a pocket or purse, the door unlocks automatically to a touch on the handle. Like-

wise, if the remote is present, pushing the ignition button on the dash starts the engine. Without the remote, the doors won't open, and the car won't start. It's a feature you'll find in some luxury cars, but it's actively rare on mainstream models.

From the outside, the Avalon is substantial and elegant. A product of Toyota's Newport Beach (Calif.) design studio, it has crisp lines and edges, giving it a more distinctive, modern look than its rounded predecessor. It's the Avalon's interior that really shines, however. The dashboard is accented by what appears to be a matte aluminum trim, but is actually painted plastic. The material is used on panels that glide open at a fingertip to reveal and conceal the radio and the heating and cooling controls, giving the dashboard a sleek, clean look.

ELBOW ROOM

WITH FRONT DOOR panels curving above the armrests, there's a lot of elbow room—literally. The one misfire on the interior of the pearl gray car I drove was the color scheme: pale gray with rich, burled walnut, which I found jarring.

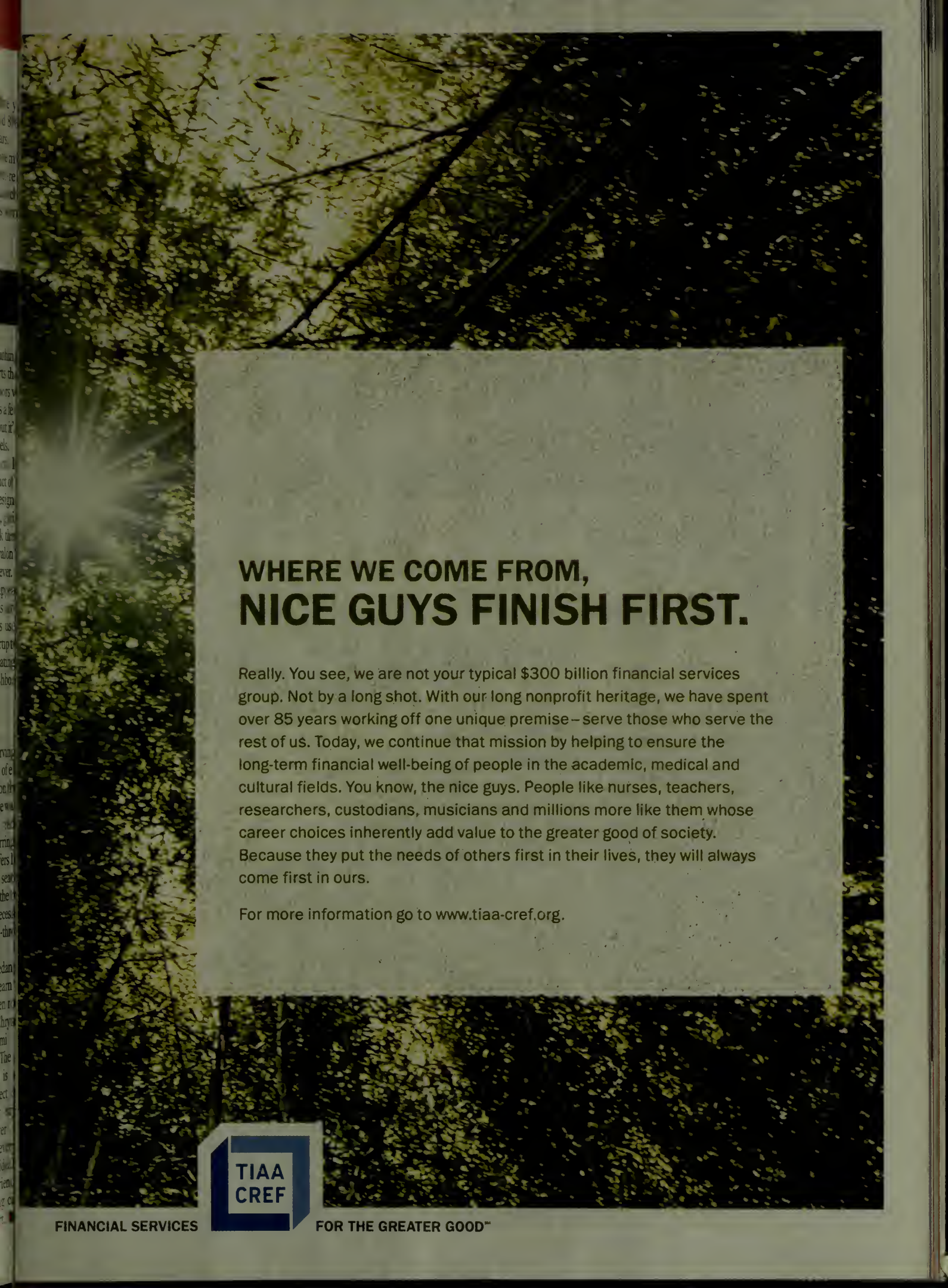
In the back seat, a flat floor offers plenty of legroom, and the cushy rear seat reclines up to 10 degrees. Although the trunk is a bit smaller than its predecessor's, the space is still ample, with a pass-through gap for skis.

INSIDE FLAIR

Sleek dash design



This is not a sedan that makes you yearn to scream down open roads. That would be Chrysler's look-at-me, Hemi-powered 300C. The flashy Avalon is the 300C's near-perfect complement: quietly stylish with more power than you'll need in everyday driving. It's the ideal car for chauffeuring friends to dinner or cruising the country in comfort. ■



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Off the Beaten Path

Can't get into the Boston Marathon? Try Prague or Monaco. **BY JOSEPH WEBER**



SO YOU'VE RUN THE NEW York, Chicago, and Boston Marathons. What other frontiers are there? Plenty. Hundreds of long-distance runs are now staged around the world, from spots as exotic as Kenya, Easter Island, and Antarctica to places as familiar as London, Paris, and Athens, the endpoint for Phidippides' run from the Marathon battlefield some 2,500 years ago. "People are using marathons as an excuse to visit countries all over the world," says John "The Penguin" Bingham, a running guide author whose namesake Ohio firm operates three half-marathons in the U.S.

Unless world records are within your reach, visiting the host countries should be a big reason for going. Most runners won't set personal bests in places where different time zones can throw off your body clock, and altitudes, road and weather conditions, even the energy drinks at rest stops may be as foreign as the language. Treat such trips as vacations first, and you won't be upset by differences from courses at home.

The changes can be sharp. Racers in the Monaco Marathon on Nov. 13 will be treated to mountain and seaside running on a course that varies from 49 feet above sea level to 275 feet. The upside: They'll zip along the Riviera, dashing by castles and venturing into France and Italy. "It's incredibly beautiful," says Chicagoan

Richard Salt. "As you go by the cafés, people hold up drinks to toast you."

Runners can expect cordiality. Edward Stuart, a Northeastern Illinois University economics professor, passed many miles in one Stockholm Marathon debating American free-market views with a Swedish socialist. Later a half-dozen runners saw his race T-shirt and invited him to dinner. "Nothing binds people together like common pain," says Stuart.

BIZARRE COSTUMES

PLAN EARLY to avoid being shut out. The Flora London Marathon, with 32,000 runners, gets three times as many applicants and admits by a lottery. For this year's Apr. 17 race, places were awarded last October. By November, no spots were available, even through groups such as Boston-based Marathon Tours & Travel, which books guaranteed-entry packages. The Apr. 10 Paris Marathon had no lottery, but all 35,000 places were filled by mid-January. Registration for the 36,000-

runner Sept. 25 Berlin Marathon will likely close by May.

That's why some veterans take roads less traveled. Cities such as Copenhagen and Prague—both hosting races on May 22—draw fewer people, but make up for that in charm. Copenhagen's 7,000 entrants run through the Carlsberg brewery. Prague's 5,000 runners hail from 55 countries. You can register online, as with most runs, or sign up through tour operators. For details, visit sites such as marathonguide.com or aims-association.org, run by the Association of International Marathons and Road Races.

Plenty of runs cater to the offbeat. A lucky 8,000 run the Medoc Marathon scampering through the estates of grape-growing chateaux in southwest France. Bizarre costumes are *de rigueur*, and wine is served at rest stops. The Sept. 10 race "is great for people who love wine and happen to run," says Thomas Gilligan, head of Marathon Tours.

If you're more adventurous, you can scale a stretch of the Great Wall of China on May 21 or zip around Easter Island in June. In July you can run with giraffes in Kenya's Lewa Wildlife Conservancy, where temperatures in the Safaricom Marathon begin in the 40s and end in the 80s. Marathonning abroad isn't as easy as at home. But conquering a course in an exotic location could be as exhilarating as crossing the tape on your first 26.2-miler. ■

SAVANNA RUN
The Safaricom Marathon in Kenya



NO SWEAT
Marathoners in Antarctica

For more on marathons around the world, go to www.businessweek.com/extras

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Making Those Pills Safe for Kids

Few medicines get tested on children. Dr. Donald Mattison is pushing to change that

FIRST THERE WERE REPORTS antidepressants increase suicidal behavior in children. Then came news of a possible cancer risk from creams used to treat baby eczema. Even a drug for attention deficit hyperactivity disorder became suspect and sales were suspended in Canada after several deaths in children.

Part of the worry is that most drugs taken by children have not been adequately tested on them. Dr. Donald Mattison, chief of the obstetric and pediatric pharmacology branch of the National Institute of Child Health & Human Development near Washington, D.C., is working to change that. Late last year his office, acting under a 2002 law passed by Congress, ordered its first set of tests of drugs used in children. It's developing a priority list of drugs to examine next. *BusinessWeek's* Carol Marie Cropper talked with him by telephone about the effort.

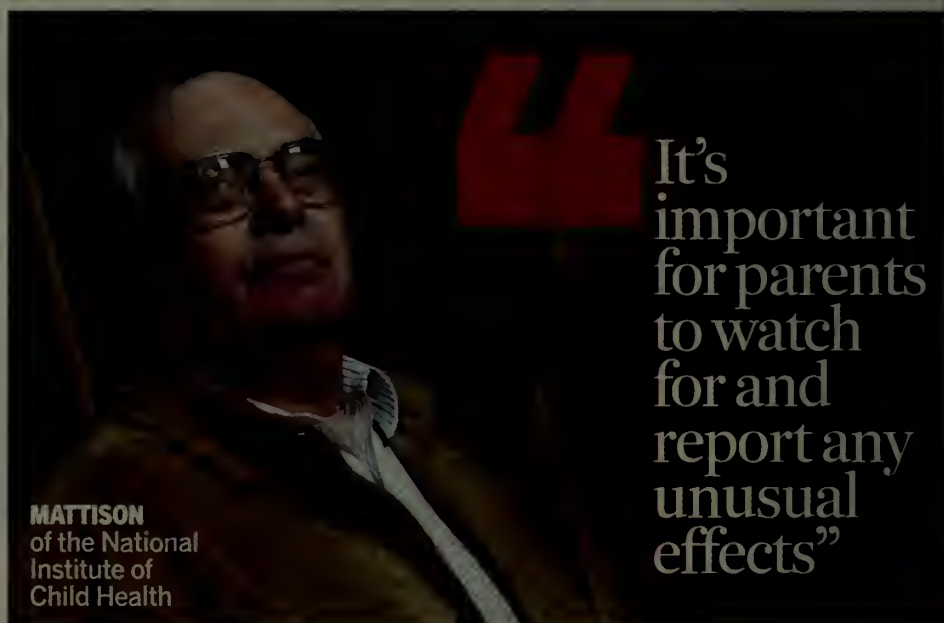
What are the facts when it comes to testing drugs used by children?

More than 90% of the drugs used in newborns and in children up to the age of 12 have never been adequately tested in those age groups—and most of them haven't been tested at all. Of the drugs used in adolescents, 75% have not been adequately tested to establish the appropriate dose and answer questions about efficacy and safety.

Why does this matter?

We're guessing that drugs are beneficial in children because they treat diseases that have some similarity to a disease in adults—with no tests on effectiveness, adverse consequences, or proper dosage. Each treatment essentially becomes an experiment on a single child.

Children don't have the same water or body-fat composition as adults. The rate



It's important for parents to watch for and report any unusual effects"

at which their livers metabolize a drug and at which their kidneys eliminate it are different. And some side effects are more of a problem in children. One of the issues with the eczema cream, Elidel, for example, is that it suppresses the immune system. We don't know the long-term effect that has in a child under 2, whose immune system is still developing.

How are you working to solve the problem?

There are about 200 off-patent drugs currently being used in children. That does not include drugs still under patent that went on the market before being tested under a 2003 law that requires pediatric

studies of new drugs. We anticipate that we'll study six drugs each year, typically by awarding contracts to pediatricians and pediatric experts at academic health centers to perform clinical trials. Our initial focus was on drugs used in critically ill children. We're now in the process of looking at drugs that are commonly used in children. My hope is that in 15 years we'll be able to say we've looked at those

What should parents do?

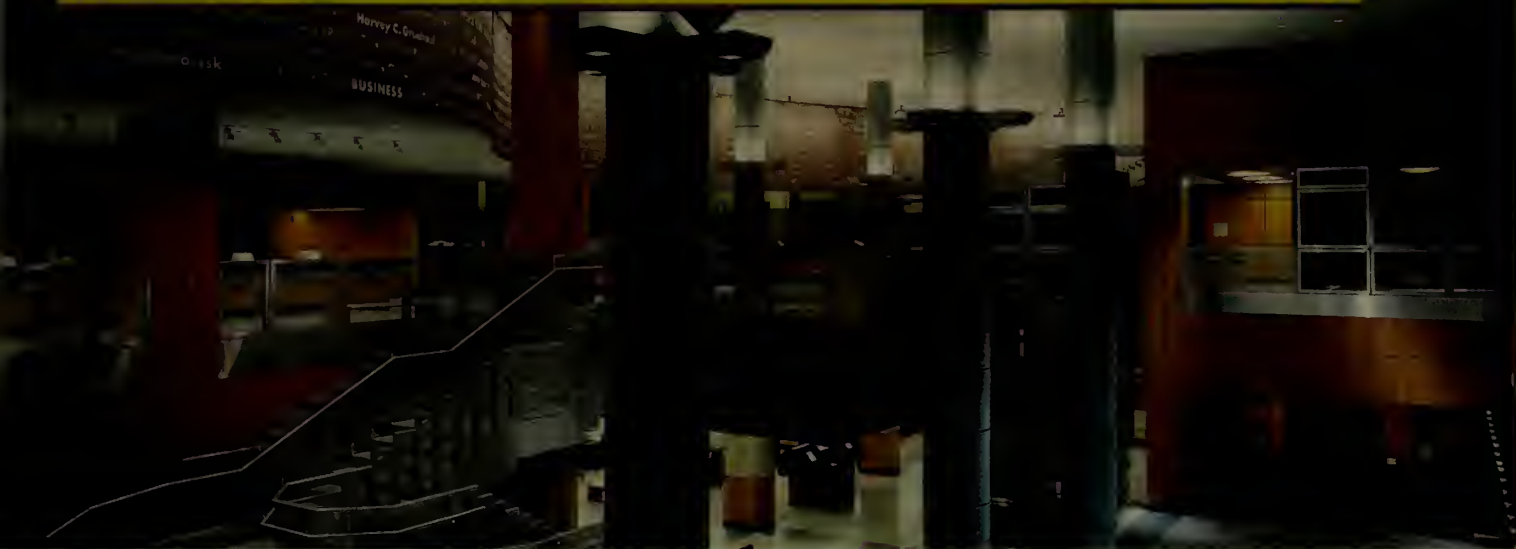
When your child gets a prescription, ask if the drug has been used a lot in children. If not, ask if another drug is available that has been used more or for a longer period of time, and [find out] whether the physician thinks this is the most appropriate drug. It's important for parents to understand the efficacy and safety issues the pediatrician is balancing. Practitioners should tell parents what side effects have been observed and whether there are any they should be especially concerned about.

Because we don't have a large amount of data, it's important for parents to watch for and report any unusual effects. That will help both the pediatrician and the rest of us understand better which drugs to use and which ones we should stay away from.

Parents can also check the Food and Drug Administration's Web site (www.fda.gov) for drug alerts. There's a Pediatrics link for information about children's drug issues and a table showing the labeling changes that have come about because of voluntary testing under a 1997 law, which gives drugmakers extra six months of marketing exclusivity in return for doing tests in children.

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BusinessWeek

EDITED BY TODDI GUTNER

MUTUAL FUNDS

SHORTCUTS AROUND A BAN

STOCKS HAVE BEEN rocky, largely because of surging energy prices. And with interest rates rising, bonds haven't been any better. Yet short-selling—betting on falling prices—isn't allowed in individual retirement accounts (IRAs) or 401(k)s. You can, however, use “inverse funds” as a proxy for a short.

Like index funds, these mutual funds track specific benchmarks, such as the **Standard & Poor's 500-stock index**, the **NASDAQ 100**, or the 10-year **U.S. Treasury bond**. Rather than try to match those marks, managers mix futures, options, and short sales to create a fund that moves in the opposite direction. Most aim to return 100% to 200% of the inverse of an index' daily performance. **Profunds' Bear ProFund** and its juiced-up sister, the **UltraBear ProFund**, for instance,

How to Short...

...THE S&P 500:

Bear ProFund (BRPIX)
Potomac U.S. Short (PSPSX)
Rydex Ursa (RYURX)

...THE NASDAQ 100:

Short OTC ProFund (SOPIX)
Rydex Venture 100 (RYVNX)

...THE BOND MARKET:

Rising Rates Opportunity
10 ProFund (RTPIX)
Rydex Juno (RYJUX)

are both linked to the S&P 500. If the index drops by 2%, the value of Bear ProFund should increase 2%. The UltraBear ProFund should jump 4%. The reverse is true if the S&P rises.

Ill-timed calls can make for losses. Last year, the **Rydex Juno Fund**, which

moves in the opposite direction from the price of long-term U.S. Treasury bonds, seemed like a sure bet. When long rates went down instead of up, Juno lost 9%.

The fees of these funds, although generally lower than employing other short strategies, are higher—1.88% on average—than those of domestic equity funds—1.24%. Shares offered through a retirement plan may be cheaper.

Still, if you're comfortable with short-selling, the inverse funds can be savvy plays. And unlike traditional shorting, the potential for loss is limited to the size of your original investment. With Apr. 15 coming soon, an inverse fund may be a good place to park your next IRA deposit.

—Adrienne Carter

KIDS

No More Mozart

VISIT ANY WEB SITE hawking educational toys and you're likely to find Mozart CDs. The sales pitch: Listening to Wolfgang Amadeus makes children smarter. Never mind that the 1993 seminal study indicating a relationship between Mozart and spatial intelligence made claims only for college students. So why did it unleash a frenzy, resulting in pregnant women playing Mozart tapes to their unborn babies? Chip Heath, an associate professor of organizational behavior at **Stanford Graduate School of Business**, and Swiss psychologist Adrian Bangerter traced the evolution of what they call a “scientific legend” in a recent study.

The clamor grew out of an experiment at the **University of California at Irvine** that showed college students who listened to a Mozart sonata for 10 minutes temporarily improved their spatial reasoning. Heath and Bangerter analyzed hundreds of news stories over the next decade and discovered that the coverage distorted the findings by linking Mozart listening to long-term intelligence gains among infants, children, and high school students. The hype continued even after 20 later studies discredited the original research. Their conclusion: The “Mozart Effect” idea persisted because it counteracted anxiety over public education.

—Susan Garland

GAMES

NOW YOU CAN USE your cell phone to ante up for real. Starting on Apr. 11, cell phone users can download a free interactive poker game at **PokerRoom.com**. (Previously, they could only go head-to-head with a computer.) You can play the ever popular Texas hold 'em, select between tables, and chat with other players. Most states ban online gambling, but like other casino sites, PokerRoom's servers are outside the U.S.



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BY ROBERT BARKER

An Energy Driller Worth Exploring

The latest jump in oil prices gives most everyone multiple reasons to frown. One more for me is the parallel pop in prices of energy stocks. It's not that I'm down on the industry: I bet crude will stay far above the \$25-a-barrel level that seemed plausible to so many last year. I just want to see good oil and gas stocks cheaper.

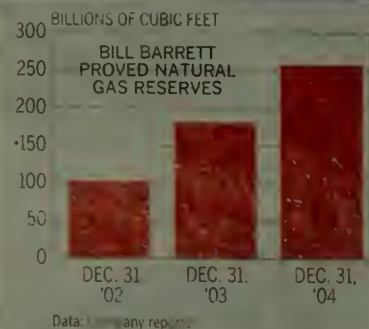
That's why I've been tracking a new and relatively unknown one, Denver-based Bill Barrett Corp. If the name faintly rings a bell, you may recall Barrett Resources, a longtime Rocky Mountains oil-and-gas driller. Founded in 1981 by noted geologist William Barrett, in 2001 it sold out to Williams Cos. for \$2.8 billion. Five months later, Barrett was at it again, forming Bill Barrett Corp. with his cohorts from Barrett Resources, including two sons and a brother-in-law. Focused on finding natural gas, it came public in December at

BARRETT'S FINANCIALS

	MILLIONS
2004 Revenues	\$170.0
2004 Net Loss	5.3
2004 Cash From Operations	87.0
Enterprise Value	1,163.2
2005 Earnings Per Share*	0.55
Stock Price (BBG)**	29.06

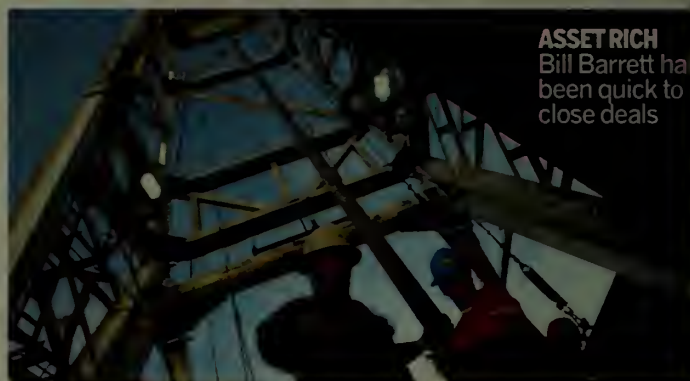
*Earnings per share, as reported
Data: Company reports, Capital IQ

ITS GAS RESERVES



\$25 a share and soon hit \$35. It caught my eye again in late March when it dipped to \$26.

Scouring rugged terrain for the right place to drive a drill bit is risky business, no question. It's ordinarily far outside my range of investment interests, among such other chancy ventures as genome mapping and teenage fashion-gazing. Every wildcatter drills plenty of dry holes, even 75-year-old Bill Barrett, who was named the American Association of Petroleum Geologists' Explorer of the Year in 2003. Yet I see his latest company, where he's CEO, as a reasonable opportunity, in part for how it is managing the inevitable risks.



ASSET RICH
Bill Barrett has been quick to close deals

How? First, by opportunistic asset-building. Soon after it bought Barrett Resources, Williams sank into a liquidity crisis prompted by Enron's fall. Forced to raise cash fast, it put on the block some fields in Wyoming's Wind River Basin it had just gained via Barrett Resources. Bill Barrett knew them well and in March, 2002, took them for \$74 million. "It was clear a distressed situation, and it allowed us to be the only logical buyer," Thomas Tyree, Bill Barrett's chief financial officer, told me. In three deals over the next year, the company spent an additional \$105 million on fields in Wind River and three other areas of the Rockies. Then Calpine, another Enron-affected energy outfit, last summer dumped properties in Colorado's Piceance Basin, an area Barrett Resources had pioneered. Bill Barrett's local smarts again let it act fast, closing a \$137 million deal in weeks.

IT'S EASY FOR DRILLERS to run up debts as they gather acreage and reserves (table). In fact, Bill Barrett borrowed \$150 million to swing the deal with Calpine. But with the \$347 million it raised in its December initial public offering, it paid back that loan along with the rest of its borrowings. At yearend, the balance sheet showed \$100 million in cash, no debt, and stockholders' equity of \$620 million.

Although the IPO was heavily oversubscribed, the insiders did not exploit the chance to cash in some shares. Besides Bill Barrett and his family, the pre-IPO stockholders included partnerships organized by Goldman Sachs, JPMorgan, and Warburg Pincus, which together now control 49% of the equity and are each seated at the directors' table. None of them is known for resisting the urge to trade paper for cash. When post-IPO trading restrictions on their shares lift in June, you might see some insider sales, particularly if the stock keeps climbing from its recent \$29. But if the stock is anywhere near where it came public, don't count on it. ■

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BY GENE G. MARCIAL

RIVAL CANDYMAKERS COULD BE HUNGRY FOR **TOOTSIE ROLL**.

BARRIER IS HEADING FOR WHAT LOOKS LIKE A BANG-UP YEAR.

TAKING ADVANTAGE OF **DORAL FINANCIAL** WHILE IT'S DOWN.

A Nibble at Tootsie Roll?

TOOTSIE ROLL INDUSTRIES (TR) isn't exactly on a roll. Since 2000, sales and earnings at the 100-year-old maker of chewy chocolate have been flat, and the stock has sagged to 30, down from 33.62 on Dec. 31. So the buzz is Tootsie may be buyout bait. "It is a brand name that would enhance any buyer," says Robert Stovall of Wood Asset Management, which owns shares. With its vast distribution and brand recognition, it would be a "great catch" for the likes of Nestlé, Hershey, or Wrigley," says Stovall. Elliott Schlang of researcher LJR Great Lakes Review says takeover talk gets louder as investors get disappointed with the stock—and as top execs get older. Tootsie Chairman and CEO Melvin Gordon is 85, and his wife, Ellen, president and COO, is 73; they own 40% of the stock and control 77% of the voting B stock. "The question is when and how much they'll ask for," Schlang says. He notes the balance sheet is solid, with understated assets, such as plants and real estate in several states, such as Illinois and Tennessee. He says the stock is worth 35 to 37 in a deal—having hit 44 in 2001. Schlang says the 2004 purchase of Concord Confections, a big Canadian bubblegum maker, will lift 2005 earnings to \$1.28 a share—adjusted for a 3% stock payout on Mar. 1—up from \$1.19 in 2004. Earnings peaked at \$1.32 in 2000. Nestlé couldn't be reached; Tootsie, Hershey, and Wrigley didn't return calls.

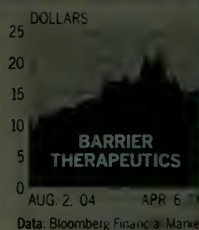


The Healthy Glow At Barrier

BARRIER THERAPEUTICS (BTRX) is a "pure play on dermatology," and 2005 should be a stellar year for the company, says Marc Goodman of Morgan Stanley, which took Barrier public in 2004 at 15. Three of its anti-fungal products—Zimycan, Sebazole, and Hyphanox—are nearing Food & Drug Administration approval. They're reformulations of O.K.'d products, so the rejection risk is small, says Goodman. He sees the FDA approving Zimycan this quarter, and a launch later in 2005. He also expects Barrier to file for Sebazole's approval in the third quarter. And data about Hyphanox' effect on vaginal yeast infections, to be released this quarter, should be favorable. The antifungal products will generate \$200 million in sales by 2009, figures Goodman. The stock hit 22 in

February, fell to 14 in March when rival Eon Labs launched a generic Hyphanox, and is now 15. Goodman says the flap was exaggerated: He believes once-a-day Hyphanox has an edge over a twice-a-day generic. His price target is 21, or 25 times his \$1.29 earnings estimate for 2008, when he expects the first full year of profits. Another Barrier fan: George Soros, whose funds own 11.5%.

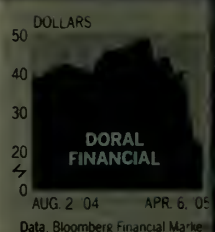
A DIP IN MARCH



Doral—After The Hammering

WHEN THE STREET TURNS on you, watch out. Doral Financial (DRL), the top mortgage lender in Puerto Rico, found out the hard way: Its shares plunged from 38 in late February to 21 on Mar. 15, when it filed a 10-K for 2004. That report raised concerns about the quality of earnings in 2005—as analysts questioned the assumptions Doral used to value \$879 million worth of certain securities—in light of the rise in interest rates. Analysts downgraded the stock and cut earnings estimates for 2005-06. But some pros took advantage of the drop: At Carret Asset Management, Donald Gimbel doubled Carret's stake, to 850,000 shares. He first bought last year, when the price was 30. Doral was featured in this column on May 3, when it stood at 32. By January, it had bolted to 49. Despite the grim forecasts, Gimbel sees earnings of \$5 a share in 2005 and \$5.50 to \$6 in 2006, vs. 2004's \$3.95. Gimbel says Puerto Rico's housing shortage will keep mortgage demand strong, so the stock should bounce back to 49 in a year. Joe Gladue of investment bank Cohen Brothers who rates the stock a buy, says it's fallen far below what is reasonable for a company originating \$8 billion in mortgages year. The business remains robust, he says, and Doral plans to sell the controversial securities. ■

THE BLOW WAS HEAVY



BusinessWeek online

Gene Marcial's Inside Wall Street is posted at businessweek.com/today.htm at 5 p.m. EST on the magazine's publication day, usually Thursdays.

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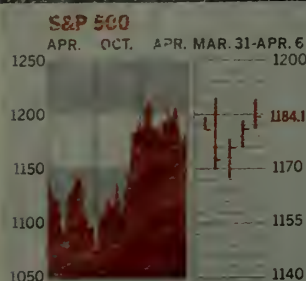
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STOCKS



COMMENTARY

The Dow and the NASDAQ fell fractionally, while the S&P 500 managed to eke out a small gain for the week. Merger activity added spice to a lazy market, as ChevronTexaco bid \$16.4 billion for Unocal, while Verizon appeared to have won the battle over MCI. Oil, though, continues to drive the bourses, with stocks slipping whenever crude gains and advancing when it falls.

Data: Bloomberg Financial Markets, Reuters

MUTUAL FUNDS

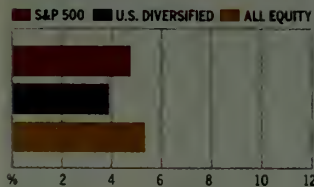
4-WEEK TOTAL RETURN

WEEK ENDED APR. 5



52-WEEK TOTAL RETURN

WEEK ENDED APR. 5



Data: Standard & Poor's

U.S. MARKETS

	APR. 6	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1184.1	0.2	-2.3	3.1
Dow Jones Industrials	10,486.0	-0.5	-2.8	-0.8
NASDAQ Composite	1999.1	-0.3	-8.1	-3.0
S&P MidCap 400	659.4	0.5	-0.6	7.5
S&P SmallCap 600	321.5	0.1	-2.2	10.3
DJ Wilshire 5000	11,670.9	0.3	-2.3	3.8

SECTORS

	APR. 6	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
BusinessWeek 50*	707.4	1.3	0.4	10.3
BW Info Tech 100**	349.6	-0.1	-6.3	-1.8
S&P/BARRA Growth	570.8	0.0	-1.9	0.7
S&P/BARRA Value	608.9	0.5	-2.7	5.5
S&P Energy	344.7	3.6	19.4	46.7
S&P Financials	382.8	-0.1	-6.9	-4.2
S&P REIT	132.1	-0.2	-8.6	11.9
S&P Transportation	223.9	-0.8	-7.3	16.0
S&P Utilities	149.5	2.2	5.6	20.7
GSTI Internet	158.3	1.6	-11.2	2.9
PSE Technology	722.8	-1.1	-7.2	-2.1

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS

	APR. 6	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST MONTH
S&P Euro Plus (U.S. Dollar)	1385.2	0.4	-0.9	16
London (FT-SE 100)	4947.4	1.0	2.8	10
Paris (CAC 40)	4107.0	1.0	7.5	4
Frankfurt (DAX)	4379.2	0.7	2.9	8
Tokyo (NIKKEI 225)	11,827.2	2.3	2.9	-1
Hong Kong (Hang Seng)	13,562.3	1.0	-4.7	5
Toronto (S&P/TSX Composite)	9673.0	2.0	4.6	9
Mexico City (IPC)	12,170.9	-3.8	-5.8	13

FUNDAMENTALS

	APR. 5	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	2.02%	2.04%	1.56
S&P 500 P/E Ratio (Trailing 12 mos.)	19.8	19.4	22.9
S&P 500 P/E Ratio (Next 12 mos.)*	15.4	15.7	16.7
First Call Earnings Surprise*	11.89%	4.00%	13.89

*First Call Co.

TECHNICAL INDICATORS

	APR. 5	WEEK AGO	REAR
S&P 500 200-day average	1152.0	1150.8	Positiv
Stocks above 200-day average	64.0%	61.0%	Neutr
Options: Put/call ratio	0.81	0.71	Positiv
Insiders: Vickers NYSE Sell/buy ratio	4.77	4.82	Negativ

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Health-Care Facilities	9.4	Oil & Gas Refining	85.7
Internet Software	6.7	Fertilizers & Ag. Chems.	67.8
Health-Care Services	5.0	Oil & Gas Drilling	66.0
Food Wholesalers	4.7	Oil & Gas Exploration	61.7
Home Furnishings	3.9	Steel	51.8

WORST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Home Entertainment	-22.2	IT Consulting	-53
Multi-line Insurers	-16.1	Insurance Brokers	-31
Agricultural Products	-15.8	Electric Mfg. Svcs.	-3
Automobiles	-12.2	Automobiles	-29
Steel	-11.8	Auto Parts & Equipment	-28

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Health	-1.0	Natural Resources	38.9
Utilities	-1.1	Latin America	26.8
Miscellaneous	-2.0	Utilities	21.7
Domestic Hybrid	-2.1	Europe	19.6
LAGGARDS		LAGGARDS	
Precious Metals	-9.6	Technology	-10.4
Latin America	-9.5	Precious Metals	-8.7
Diversified Emerg. Mkts.	-6.1	Japan	-4.9
Financial	-5.1	Health	-3.0

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Rydex Inv. Dyn. Dow 30 H	8.8	ProFunds Oil & Gas Inv.	72.3
ProFunds USh. Dow 30 Inv.	8.8	BlackRock Gl. Res. Inv. A	54.7
ProFds. USh. Sm. Cap Inv.	7.5	Fidelity Select Nat. Gas	53.6
Potomac Sm. Cap/Sh. Inv.	6.9	Select Sctr. SPDR Energy	48.7
LAGGARDS		LAGGARDS	
American Heritage Growth	-14.3	Apex Mid Cap Growth	-41.0
ProFunds Pr. Mtls. Inv.	-13.4	ProFunds Semldr. Inv.	-35.0
U.S. Global Invs. Gold	-12.8	Reynolds	-33.8
U.S. Gl. Invs. Prec. Mnls.	-12.4	Van Wagoner Emerg. Gr.	-30.4

INTEREST RATES

KEY RATES

	APR. 6	WEEK AGO	YEAR AGO
Money Market Funds	2.29%	2.26%	0.57
90-Day Treasury Bills	2.76	2.82	0.93
2-Year Treasury Notes	3.69	3.83	1.84
10-Year Treasury Notes	4.43	4.55	4.16
30-Year Treasury Bonds	4.74	4.80	5.01
30-Year Fixed Mortgage†	5.93	6.00	5.73

†BancQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
General Obligations	3.86%	4.57%
Taxable Equivalent	5.51	6.53
Insured Revenue Bonds	3.98	4.64
Taxable Equivalent	5.69	6.63

THE WEEK AHEAD

INTERNATIONAL TRADE Tuesday, Apr. 12, 8:30 a.m. EDT » The February foreign trade deficit is forecast to be \$59 billion, after a January trade gap of \$58.3 billion. That's based on the median estimate of economists surveyed by Action Economics.

RETAIL SALES Wednesday, Apr. 13, 8:30 a.m. EDT » Retail sales most likely increased by 0.6% in March. February retail sales rose 0.5%. Minus vehicles,

sales probably grew by 0.5%, after a 0.4% gain in the prior month.

BUSINESS INVENTORIES

Thursday, Apr. 14, 8:30 a.m. EDT » February inventory levels most likely expanded 0.7%, after a 0.9% rise in January.

EXPORT-IMPORT PRICES Friday, Apr. 15, 8:30 a.m. EDT »

March export prices are expected to have increased 0.3% after holding steady in February. Import prices, fueled by rising crude oil

prices, probably surged 0.9%. February import prices rose 0.8%.

INDUSTRIAL PRODUCTION

Friday, Apr. 15, 9:15 a.m. EDT » March industrial output most likely expanded 0.3% for a second straight period. The latest jobs report showing a decline in both the factory workweek and overtime poses a downside risk. The average monthly operating rate probably edged up to 79.5%, from 79.4% in February.

The BusinessWeek production index edged up to 239.2 for the week ended Mar. 26, and stood 11.2% above the year-ago reading. Before calculation of the four-week moving average, the index fell to 238.8.

BusinessWeek online

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/magazine/extra/

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B-Schools for The 21st Century

THE MARKET IS sending a troubling message to America's business schools. Falling applications, sliding enrollments, and declining selectivity all point to problems. The obvious culprit is the soaring price of tuition—up to \$39,100 a year at Harvard B-School—at a time when starting MBA salaries have remained flat for years. But the meta-message may be much more serious. The market may be telling the B-schools that they are training managers for the 20th, not the 21st century. More and more corporations prefer to train their own managers in-house, but not just because of the rising cost (page 28). They also want to instill skills and values that B-schools don't, can't, or won't deal with.

For the many business schools, the speed of change in the global economy and in corporate culture may be making part of their curriculum obsolete. Outsourcing to India and China, the rise of customer power, the spread of broadband, and other huge developments are changing not only the economic context in which companies operate. They are also changing the way companies operate. CEOs of global corporations are

demanding that their people be able to manage innovation teams, manage global supply chains, manage strategic design, and manage the consumer experience.

Are B-schools keeping up? Despite scattered courses in product design and development, most B-school curriculums still focus on analytical courses—accounting, marketing, and finance. But today, companies increasingly need softer people skills: observing consumers, collaborating with teams, conceiving new brands, and, perhaps most important, working across cultures with Chinese, Germans, Indians, Italians, Russians, and a world full of suppliers and partners.

People skills and cross-cultural teamwork are what MBAs need

Unfortunately, many B-schools still appear to be graduating twenty- and thirtysomethings, many of whom believe they can

manage by the numbers when more businesses are stressing the importance of organic growth through new products and services. Raising innovation success rates today is far more important than improving Six Sigma results.

In times of economic upheaval, when the speed of change is enormous, the business world often adapts faster than academia. The drop in B-school enrollments may be signaling that people think they will receive better training inside Corporate America than out. If that is true, B-schools have a lot more learning to do before they can successfully teach this generation of managers.

Jobless in Detroit—And Germany

WHAT DO MICHIGAN and Germany have in common? Unemployment. Michigan, at 7.5%, has the highest unemployment rate of any state in the U.S. Germany, at 12%, has the highest unemployment rate of any major industrial country in the world. In Michigan, the problem is sclerotic corporate health-care, pension, and wage policies that are hugely expensive. In Germany, where the government controls these policies, the problem is national. Yet the result is the same: Manufacturers are increasingly uncompetitive in the global economy. People who still have jobs and those who are retired are doing quite well, but at the expense of their children and others who can't get jobs because companies find the cost of hiring prohibitive.

The obvious solution is to make health care, pensions, and wages more flexible and less generous—to give companies

more incentive to hire. In Germany, political pressures have slowed moves to reform. In Michigan, unions have stopped companies, particularly Detroit auto makers, from taking the necessary steps. It may take bankruptcy to allow one or more of them to do what they need to do. General Motors Corp. is just one step removed from junk-bond status as a result of a recent credit downgrading.

But the burden of health care and pensions is only one reason for high unemployment rates. Detroit's corporate managers bear some of the blame. As gas prices surge well above \$2 a gallon, the product mix isn't right. Wedded to gas guzzling trucks and SUVs, the U.S. is way behind Japan in selling cars with hybrid engines. And while DaimlerChrysler has come out recently with beautifully designed cars, consumers have found GM and Ford models lacking.

Germany's high unemployment problem is more clearly a political problem of an aging population trying to maintain its prosperity in the face of intense global economic competition. Germany is not about to go into bankruptcy, as private company might, but at some point unemployment will rise high enough to trigger an equivalent political crisis.

The rise of Asia and Eastern Europe as inexpensive manufacturing centers is changing the nature of international competition. Sadly, it looks as though it will take a corporate financial crisis in the state of Michigan and a political crisis in Germany to force the kind of policy changes that can ultimately lead to a drop in their high unemployment rates.

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April 25



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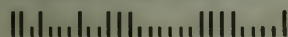
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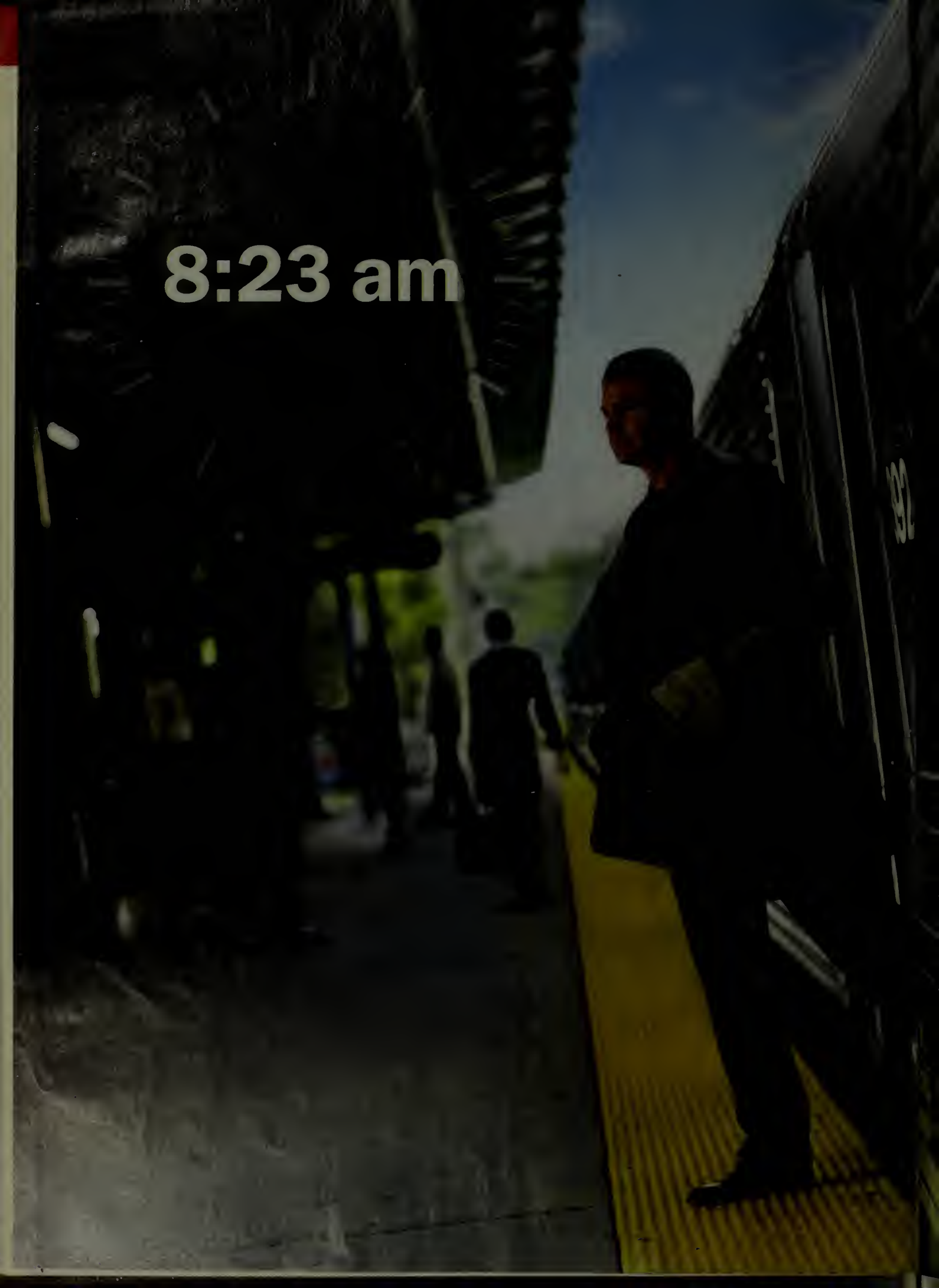
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When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

LIQUOR BRAND/PRICE* OUR AWARD

TOP 3 GINS

Hendrick's \$30/750ml	Most Flavorful
--------------------------	-------------------

Tanqueray No. Ten \$26/750ml	Smoothest
---------------------------------	-----------

Juniper Green Organic \$26.50/750ml	Best Presentation
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Investing Special Report: Death of a Stock Salesman

Are **stockbrokers** becoming extinct? With discount brokerages eroding profit margins, only wealthy clients get face-to-face attention from a new breed with names like financial planner or investment adviser. This report examines what the new titles mean, how these folks are **regulated**, and how this trend affects individual investors. Plus: An **Interactive Quiz** that tests your money IQ; tips to help you **find a financial coach of your own**; and more



The Curious Case of the Missing Trillion

Robust productivity growth means the U.S. produced at least that much extra output in 2004. But where exactly did it go? *BusinessWeek* Chief Economist Michael Mandel takes a look



Tune In for the Invasion Of the Robo-DJs

With satellite making inroads, broadcasters are trying "Jack format" radio stations, betting that iPod-style shuffled playlists will keep listeners from straying. Cool idea, but probably not cool enough



Leading Regime Change, The Pope's Way

John Paul II subtly spurred peaceful progress in Poland. If the U.S. wants such sway, it needs to regain some moral stature with more good deeds



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JP Front

"Obviously, nothing like this can continue forever..."

—Gordon Moore, conceding that his 1965 prediction—computer-chip performance would double every year or two—will soon have run its course

EDITED BY IRA SAGER

PATENTS BLACKBERRY'S PATENT RAMBLE

LAST MONTH, Research In Motion (RIM), maker of the ubiquitous BlackBerry, welcomed the chance to pay \$50 million to settle a furious legal battle over patents held by NTP, a small patent-holding company. But RIM may regret making the deal. On Apr. 6, the U.S. Patent & Trademark Office overruled one of the patents NTP had accused RIM of infringing and gave a strong indication it might reject the other two, too. The agency has been



taking a second look at eight NTP patents ever since NTP sued the Waterloo (Ontario) company in December, 2002. So far, patent examiners have rejected three of the patents—including the one in the RIM case—held by NTP, based in Arlington, Va.

RIM declined to comment on the patent office decision. It has said the settlement

with NTP is "full and final." The matter might be behind RIM, but it certainly isn't over. NTP will surely appeal the patent office rejection, a process that could take years and end up right where it started—

back in court. Regardless of the outcome, NTP will be ahead by at least \$450 million.

—Lorraine Woellert



PC PATROL

Spyware: Suddenly, Eliot Pops Up

IS NEW YORK ATTORNEY GENERAL ELIOT SPITZER taking on spyware? In an April 12 Securities & Exchange Commission filing, **Intermix Media**, a Los Angeles purveyor of online greeting cards and games, says it received notice Spitzer is considering legal action. The AG's office alleges Intermix "distributed downloads that were installed by users without sufficient notice or consent and in a manner that made it difficult to locate and remove." Intermix says it's cooperating with Spitzer and has been scaling down the part of its business that enables spyware.

The move likely won't halt Spitzer. "There is a real [chance] of an enforcement action," says a person familiar with the investigation. A Spitzer anti-spyware campaign should be applauded by beleaguered PC users increasingly incensed at the number of unwanted pop-up windows unleashed by the stealth software. A study by **America Online** and the National CyberSecurity Alliance estimates that 80% of computers have spyware. What's more, spyware is widely blamed for identity theft since some programs steal data such as passwords.

A source close to Spitzer expects details about legal moves against Intermix to be disclosed by the end of April. Given Spitzer's track record of widening investigations, other alleged spyware companies should probably watch out. —Brian Grow

THE BIG PICTURE

MINORITY REPORT *DiversityInc* magazine ranked companies based on commitment to employee and supplier diversity as well as on jobs held by minorities. Here are the top five:

- ALTRIA
- TURNER BROADCASTING
- CITIGROUP
- PEPSICO
- ABBOTT LABORATORIES



© DiversityInc 2005 survey of 203 companies

WEB WATCH

MEETUP SAYS: 'PAY UP'

MEETUP, THE WEB SITE best known for launching Howard Dean's brief Presidential candidacy, wants its 2 million



members to pay up. Come May 1, organizers of Meetup groups, which form online but meet in the real world, will be charged up to \$19 a month to main-

DEAN Activists will get new organizing tools

tain an online presence.

CEO Scott Heiferman hopes the proceeds will help the three-year-old meeting site turn a profit by yearend. But he's also hoping to boost marketing and develop new organizing tools so groups can team up to take political action. Meetup groups of tech writers in India are already banding together and pushing for higher wages.

Heiferman admits he could lose "a lot" of the 54,000 managed groups. Mike Sedita, leader of a bulldog owners' group in New Jersey, says he won't pay. But hey—it's not 1999 anymore. Even Web sites with a noble mission to restore a sense of community now have to earn their keep.

—Robert D. Hof



BUYERS BEWARE

SCANDAL SHEET Mortgage Broker Hires Hit Man; Fugitive Pair on Mortgage Fraud Spree. Tabloid headlines? No, just a couple from MortgageDaily.com. The online newsletter covers mortgage products and the like. **But it's the sordid tales that draw readers—80,000 a month,** twice the Net traffic of rival National Mortgage News. The housing boom clearly has brought more fraud: The IRS says real estate fraud investigations doubled between 2001 and 2003. Not to mention a boom in readership for MortgageDaily.com. —Marcia Vickers

FUND CITY

THANKS FOR THE SIDEWALK, WALL STREET

AS SECURITIES trading has become a more diverse and global pursuit, the portion of U.S. traders who work in New York has plummeted—to 23.4% in 2004, down from 42.5% in 1973. But a new report from the **Securities Industry Assn.** suggests that number has finally leveled off, remaining nearly flat for the past three years.

Good news for the city's economy: The securities industry makes up just 4.5% of the local workforce, but it accounts for 19.2% of city income. That's a lot of tax revenue keeping the Big Apple sweet. —Jessi Hempel

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Susan Winterode
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FACE TIME

LOU GERSTNER



UP THE DOWN STAIRCASE—WARILY

Saving IBM may look easy compared with Lou Gerstner's latest task: saving America's schools. After retiring in 2002 as chairman and CEO of Big Blue, he founded the Teaching Commission to improve teacher quality. Now, Gerstner, 63, is pushing to give educators a raise—and link salaries to performance.

Makes sense. However, a poll the commission unveiled on Apr. 6 suggests the difficulties Gerstner faces. True, a surprising 70% of adults support pay hikes—even if it means higher taxes. But they're unsure about Gerstner's notion of tying pay to test scores. Two-thirds say teachers should get "extra pay" linked to "tests and other indicators." But just 41% thought tests alone should influence pay.

Still, says Gerstner, "every day we subject our kids to unqualified teachers, because we're underpaying them and not attracting the right people into the profession. On that, there seems to be a consensus."

—Aaron Bernstein

SHOW BIZ

BARRY DILLER ON THE GRILLER

FOR A TOUGH-MINDED deal-maker who doesn't take rejection lightly, Barry Diller recalls one of his first big disappointments came as a freshman on the Beverly Hills High School newspaper. He was fired for never showing up by the editor-in-chief, Nora Ephron, now a noted author and film director. Chalk it up to teenage whimsy, because for the past 40 years, the CEO of IAC/InterActiveCorp has shown up plenty—first making his mark as a top programmer in television, then as a studio chief, and more recently in the fast-paced world of e-commerce. *BusinessWeek* Managing Editor Mark Morrison spoke with Diller on Apr. 7 as part of the Captains of Industry series at Manhattan's 92nd Street Y. Here are some edited excerpts:

CHARITY CASES GUARANTEED FREE OF TERRORISTS

SINCE SEPTEMBER 11 the U.S. has frozen the assets of 40 Islamic charities suspected of financing terrorists—chilling Muslim-American giving and causing many charities to shut down. On Mar. 26, more than 20 Muslim charities created a new group to set guidelines to



make their governance and funding more transparent.

U.S. Islamic groups meeting rules set by the National Council of American Muslim Nonprofits can become members. That assures donors their funds go to legit groups. The Council won't "provide safe harbors from legal action,"

says Juan Carlos Zarate, an Assistant U.S. Treasury Secretary. But it helps address a crisis of trust.

—Jessi Hempel

MUSLIM SCHOOL
Renewed trust for fund-raisers

On his former ABC and Paramount colleague Michael Eisner:

I think of Michael as part of my family. This book by Jim Stewart [*DisneyWar*] is very one-note when it comes to Michael. It doesn't talk about the fact that if you look at what [Walt Disney] was and what it became, his is a truly great career. The downslopes—the ends of careers—are usually never pretty for anybody.

On Rupert Murdoch:

You referred to me as a risk taker. I'm a Tweety Bird compared with Rupert. He's the only true internationalist in media. Politically we are hardly on the same planet, but I have great respect for him as a businessperson and as a person who engenders great loyalty.

On IAC's buying Ask Jeeves:

We were concerned that our business could be disintermediated by powerful search engines, so we thought defensively about what to do. Look, I would have liked it if we had found [Google founders] Sergey [Brin] and Larry [Page] in kindergarten. But Ask Jeeves today is a better search engine, founded on contextual search, not algorithmic search.

On getting back into the entertainment industry:

All things interactive and digital are going to deeply affect the narrative forms of entertainment. So I would say [Hollywood] is not in my buried history. But if you're asking me: Would I like to run a major motion picture studio? I would rather be a waiter.

BusinessWeek online For more on Diller go to businessweek.com/mediacenter



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The Web's Future Is You

IF YOUR BLOG suddenly requires pictures of the bulls running in Pamplona, you may find good photographs, free of charge, on Flickr. It's a Web site whose members post pictures of anything and everything—conveniently tagged so that the endless cascades of images are actually easy to search.

This concept appealed to the creators of Yahoo! Inc., the proto search engine that has evolved into a spinning galaxy of searchable content. In March the company purchased Flickr for undisclosed millions of dollars. Yahoo didn't invent the tagging software, interfaces, or other innovative twists found on Flickr. But by acquiring and integrating such sites, Yahoo has increased its gravitational force, emerging as the world's premier showcase of Internet innovations.

What drives this expansion is a desire on the part of founders Jerry Yang and David Filo to make their creation the most alluring destination on the Net. Yahoo now reaches nearly half a billion users in 25 countries and 13 languages. And what continues to draw crowds is its unwavering focus on whatever is new. For example, when Flickr ties together the ethos of community and search, "photos become a very different thing," Filo explains. "We're trying to push that in lots of different directions."

Yang and Filo were the first to prove that guiding people around a largely-free Internet could be a profitable business. Back in February, 1995, the two electrical engineering doctoral students at Stanford University were simply keeping a list of links to their favorite sites on a relatively new phenomenon called the Internet. Soon lots of folks were clamoring to use "Jerry and David's Guide to the World Wide Web," to which they quickly attached a snazzier name. Today, the company's business plan remains deceptively simple: The more time users spend with Yahoo, the more advertising the site can sell, and the greater the likelihood someone will pay for premium service or content. In 2004 sales rose 120%, to \$3.6 billion, while net profits surged 253%, to \$840 million.

Known as Chief Yahoos within the company, Yang and Filo leave day-to-day business matters to CEO Terry Semel. They spend their time contemplating a day—fast approaching—

Yahoo's Filo and Yang say creative power will shift to the individual



when broadband extends out to every electronic gizmo. With that, and the upwelling of communal energy typified by Flickr, the Internet's infancy is coming to a close, say the co-founders. The first period involved shifting real-world activities such as shopping and dating into a virtual world, dominated by the PC. But in the Net's second act—the era of broadband—creative power will shift into the hands of individuals, who will be just as likely to generate and share their own content as to consume someone else's. Then, sites like Flickr could evolve into shared pools of real-time

footage on breaking news—the floods, funerals, and affairs of state that bloggers have already tackled in the world of text.

Yahoo aims to continue its role as middleman in Act II, helping its members locate whatever content they seek, formatting the sights and sounds to fit the smallest cell phones or a wall-size TV. "I remember this photo somewhere," Yang muses. "I don't know if it was on the phone, or at home on a PC, or on my TiVo or iPod. I need to do a cross-device search—not looking for something 10 million people in the world need, but for the most important thing to me." It's a personalized future that Yang and Filo have glimpsed. The two dreamers may not invent it, but they are bound to help weave all the strands together. ■

—By Cliff Edwards

BusinessWeek online For an interview with Jerry Yang and David Filo go to www.businessweek.com/extras

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Readers Report

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May I suggest that in future years the [BusinessWeek 50] cover should read: 'apparently the top performers.' "

—Uwe Reinhardt
 Princeton University

THE BUSINESSWEEK 50: CAUTIONARY NOTES

"THE BUSINESSWEEK 50" (Cover Story, Apr. 4) announces this year's list of "the top performers." May I suggest that in future years the cover should read: "apparently the top performers." Even after the passage of the Sarbanes-Oxley Act, with its stringent Section 404, we still read in the papers that this or that hitherto-acclaimed company will have to restate earnings reported in prior years. In the 1990s the business press earned itself no glory by glorifying one Potemkin village after the other in the business world—Enron and WorldCom being only the most visible among them. It is time that the business press started hedging its praise.

—Uwe Reinhardt
 Princeton University
 Princeton, N.J.

SEVEN OUT OF your top 11 performers are from the oil and energy sector. So much for the invisible hand.

—Rama Rao
 Irvine, Calif.

EVERY TIME YOU publish a list of the top companies with pictures of their CEOs, I

am struck by the lopsided proportion of old white guys, and I sigh.

—Paula Berinst
 Thousand Oaks, Ca

THE CO-PILOT WHO HELPED NUCOR SOAR

ALTHOUGH DANIEL R. DiMicco has taken Nucor Corp. to new heights ("Soar on wings of steel," The BusinessWeek, Apr. 4), Kenneth E. Iverson deserves a lot of credit for taking Nucor from near oblivion to a successful company. His genius in labor relations made the Nucor production employees the best-paid workers in the steel business while giving Nucor the industry's lowest labor costs.

—J.E. Fran
 Charlotte, N

PREDATORY LENDING: THE WRONG APPROACH

I WORK IN LENDING and, along with everybody I know in this business, support predatory-lending laws. However, I must comment on "Congress draws bead on predatory lending" (Washington Outlook, Apr. 4) and the battle between Washington and the states. I can certainly understand the states' take on the iss

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BusinessWeek

APRIL 25, 2005 (ISSN 0007-7135) *** 3930

Published weekly, except for one week in January and one in August by The McGraw-Hill Companies, Inc. **FOUNDER:** James H. McGraw (1860-1948).

EXECUTIVE, EDITORIAL, CIRCULATION, AND ADVERTISING OFFICES: The McGraw-Hill Companies Building, 1221 Avenue of the Americas, New York, N.Y. 10020. Telephone: 212-512-2000. Tele: Domestic 127039; Intl. 2360127039. Call 1-800-298-9867 or email: busweek@mhfrmsinc.com. Subscriber Services: 1-800-635-1200. TDD: 1-800-554-1579

POSTMASTER: Send address changes to BusinessWeek, P.O. Box 53235, Boulder, CO 80322-3235. Periodicals postage paid at New York, N.Y., and at additional mailing offices. Canada Post Publication Mail Agreement Number 40012501

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Readers Report

CORRECTIONS & CLARIFICATIONS

In "The revenge of Steve Wynn" (The Corporation, Apr. 11), we said that a \$300 million increase in the budget for the Wynn Las Vegas hotel and casino could become a concern for investors. We should have included comments from Ronald J. Kramer, president of Wynn Resorts Ltd., who said that the increase resulted from the addition of revenue-generating facilities. Kramer adds that those changes had been contemplated since the start of the project.

In "Now that's a liquid investment" (Personal Business, Apr. 18), the correct name of analyst Debra Coy's firm is Stanford Washington Research Group.

and the consumer advocate groups' decision to side with them.

The subprime market has its place in the lending world. Many lenders pull out because it is too difficult to abide by 50 different state laws and the various local laws of county and town governments. As a result, consumers who are in need of credit and who cannot otherwise get it in a conforming market are squeezed out

and cannot attain the American dream of homeownership.

The states are right about one thing: By keeping individual states involved in the process, we might get rid of predatory lending—not directly because of the laws, but because lenders will eventually pull out of these markets.

—Michael Tano
Branch Manager
New South Federal Savings Bank
Pensacola, Fla.

A CLEARER EYE ON ORACLE AND THE DATABASE MARKET

"LARRY, YOU PICKED a nasty fight" (News: Analysis & Commentary, Apr. 4) about Oracle Corp. vs. SAP stated that Oracle Corp. "clearly dominates" [the database software] business. While Oracle is a major player, DB2 from IBM has a similar share of the market and SQL Server from Microsoft Corp. also has a significant share. There are other major players in the market including Teradata and Sybase Inc. "Clearly dominates" grossly overstates Oracle's position in the database market.

—Sid Adelman
Sherman Oaks, Calif.

GM: SOME WORDS OF ADVICE FROM THE FANS

"RUNNING OUT OF GAS" (News: Analysis & Commentary, Mar. 28) said General Motors Corp. should cut back because "[it] doesn't have many products that are hot right now." At the Greater St. Paul Minneapolis International Auto Show, Buick had an absolutely stunning convertible concept car—a true four-seater with real legroom in the back and wheels way out at the corners, I must assume gobs of smooth power, and all the nice trimmings one could imagine. It was a 100% jewel able to pull people into the showroom and dazzle them on the streets! But alas: "We have no plans to make it anytime soon." GM, forget for moment about car loans, union woes, and pensions. Take risks on excellent products. Build that Buick, and make every element just right. Get in the habit.

—George Anderson
Champlin, Minn.

PHASE OUT BUICK or Pontiac? Why not Saturn, which is completely redundant. Saturn has weak products and is mostly known for its outstanding customer service and retail network. Is there anything



Why did I ask my doctor about Cialis?

Cialis is not for everyone. If you take nitrates, often used for chest pain (also known as angina), or alpha-blocker (other than Flomax 0.4 mg once daily), prescribed for prostate problems or high blood pressure, do not take Cialis. Such combinations could cause a sudden, unsafe drop in blood pressure. Don't drink alcohol in excess (to a level of intoxication) with Cialis. This combination may increase your chances of getting dizzy or lowering your blood pressure. Cialis does not protect a man or his partner from sexually transmitted diseases, including HIV. The most common side effects with Cialis were headache and upset stomach. Backache and muscle ache were

out Saturn to which a competent market-expanding Chevy would not aspire? Couldn't the Saturn Sky be the next Camaro? Shouldn't the Saturn Aura be a better Chevy Malibu? Now hear this: Merge Saturn and Chevy. If the Saturn is positioned as midmarket and a cover for Euro-style Opel, and Chevy is downmarket and domestic, I'd say there isn't a downmarket anymore, and GM certainly can't afford to have its largest division there. GM has declared "Chevrolet" to be its new global brand from Chile to Korea. Merge the best, purge the rest, and blend with Opel. That will save a bundle in the out-years.

—Jay Martin
Seattle

ANDY GROVE CAN ADD NBR TO HIS LIST OF ADMIRERS

WE READ WITH great interest Jeffrey E. Garten's column "Andy Grove made the elephant dance" (Economic Viewpoint, Apr. 11), reflecting on Andrew S. Grove's pending retirement. Just to set the record straight, *Nightly Business Report*, distributed to Public Broadcasting System stations across America, was pleased that the Harton School joined with us to name

the 25 most influential business persons of the past 25 years. Grove topped our list, which we unveiled as the centerpiece of a TV special that marked the occasion of the 25th anniversary of *Nightly Business Report*, the nation's longest-running daily business news program.

—Linda O'Bryon
Senior Vice-President & Executive Editor
Nightly Business Report
Miami

PARTS OF SOCIAL SECURITY THAT DON'T NEED FIXING

IN "WHY PRIVATE accounts are bad public policy" (Economic Viewpoint, Apr. 4), Robert J. Barro cites changes in life expectancy in blithely recommending that the retirement age be pushed beyond 67. Many of us hope to work long past our sixth decade, but we all know people who are ill and failing by their early 60s. Life expectancy and health do not, unfortunately, progress hand-in-hand.

—Mary C. Combs
Gaithersburg, Md.

BARRO SUGGESTS AN "acceptable standard of living" would result by indexing baseline Social Security benefits to prices

rather than wages. A recent Congressional Research Service study estimates that the Social Security benefit for a person with average earnings over a lifetime and retiring in 2005 would have been slashed from \$15,336 per year to \$6,180 per year had the initial benefit been based on increases in prices rather than wages.

—Mark L. Smith, President
Iowa AFL-CIO
Des Moines

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because it's not just about me, is it.

6-hour Cialis. When the moment is right, will you be ready? You're not the only one who will be glad you talked to your doctor about Cialis (see-AL-iss). Cialis lets you and your partner choose when the moment is right. Cialis is the only erectile dysfunction tablet clinically proven to not only work fast, but also work up to 36 hours.* Having up to 36 hours means you can take your time, not rush and be ready when the moment is right.

Ask your doctor if prescription Cialis is right for you. See important safety information below and Patient Information on following page.

Individual results may vary. Not studied for multiple attempts per dose.



www.cialis.com

1-877-4-CIALIS

As reported, sometimes with delayed onset. Most men weren't bothered by the side effects enough to stop taking Cialis. Although a rare occurrence, men who experience an erection for more than 4 hours (priapism) should seek immediate medical attention. Discuss your medical conditions and medications with your doctor to ensure Cialis is right for you and that you are healthy enough for sexual activity.

In clinical trials, Cialis was shown to improve, up to 36 hours after dosing, the ability of men with ED to have a single successful intercourse attempt.

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Patient Information



Read the Patient Information about CIALIS before you start taking it and again each time you get a refill. There may be new information. You may also find it helpful to share this information with your partner. This leaflet does not take the place of talking with your doctor. You and your doctor should talk about CIALIS when you start taking it and at regular checkups. If you do not understand the information, or have questions, talk with your doctor or pharmacist.

What important information should you know about CIALIS?

CIALIS can cause your blood pressure to drop suddenly to an unsafe level if it is taken with certain other medicines. You could get dizzy, faint, or have a heart attack or stroke.

Do not take CIALIS if you:

- take any medicines called "nitrates."
- use recreational drugs called "poppers" like amyl nitrate and butyl nitrate.
- take medicines called alpha blockers, other than Flomax® (tamsulosin HCl) 0.4 mg daily. (See "Who should not take CIALIS?")

Tell all your healthcare providers that you take CIALIS. If you need emergency medical care for a heart problem, it will be important for your healthcare provider to know when you last took CIALIS.

After taking a single tablet, some of the active ingredient of CIALIS remains in your body for more than 2 days. The active ingredient can remain longer if you have problems with your kidneys or liver, or you are taking certain other medications (see "Can other medications affect CIALIS?").

What is CIALIS?

CIALIS is a prescription medicine taken by mouth for the treatment of erectile dysfunction (ED) in men.

ED is a condition where the penis does not harden and expand when a man is sexually excited, or when he cannot keep an erection. A man who has trouble getting or keeping an erection should see his doctor for help if the condition bothers him. CIALIS may help a man with ED get and keep an erection when he is sexually excited.

CIALIS does not:

- cure ED
- increase a man's sexual desire
- protect a man or his partner from sexually transmitted diseases, including HIV. Speak to your doctor about ways to guard against sexually transmitted diseases.
- serve as a male form of birth control

CIALIS is only for men with ED. CIALIS is not for women or children. CIALIS must be used only under a doctor's care.

How does CIALIS work?

When a man is sexually stimulated, his body's normal physical response is to increase blood flow to his penis. This results in an erection. CIALIS helps increase blood flow to the penis and may help men with ED get and keep an erection satisfactory for sexual activity. Once a man has completed sexual activity, blood flow to his penis decreases, and his erection goes away.

Who can take CIALIS?

Talk to your doctor to decide if CIALIS is right for you.

CIALIS has been shown to be effective in men over the age of 18 years who have erectile dysfunction, including men with diabetes or who have undergone prostatectomy.

Who should not take CIALIS?

Do not take CIALIS if you:

- take any medicines called "nitrates" (See "What important information should you know about CIALIS?"). Nitrates are commonly used to treat angina. Angina is a symptom of heart disease and can cause pain in your chest, jaw, or down your arm.

Medicines called nitrates include nitroglycerin that is found in tablets, sprays, ointments, pastes, or patches. Nitrates can also be found in other medicines such as isosorbide dinitrate or isosorbide mononitrate. Some recreational drugs called "poppers" also contain nitrates, such as amyl nitrate and butyl nitrate. Do not use CIALIS if you are using these drugs. Ask your doctor or pharmacist if you are not sure if any of your medicines are nitrates.

- take medicines called "alpha blockers", other than Flomax® 0.4 mg daily. Alpha blockers are sometimes prescribed for prostate problems or high blood pressure. If CIALIS is taken with alpha blockers other than Flomax® 0.4 mg daily, your blood pressure could suddenly drop to an unsafe level. You could get dizzy and faint.

- you have been told by your healthcare provider to not have sexual activity because of health problems. Sexual activity can put an extra strain on your heart, especially if your heart is already weak from a heart attack or heart disease.

- are allergic to CIALIS or any of its ingredients. The active ingredient in CIALIS is called tadalafil. See the end of this leaflet for a complete list of ingredients.

What should you discuss with your doctor before taking CIALIS?

Before taking CIALIS, tell your doctor about all your medical problems, including if you:

- have heart problems such as angina, heart failure, irregular heartbeats, or have had a heart attack. Ask your doctor if it is safe for you to have sexual activity.
- have low blood pressure or have high blood pressure that is not controlled
- have had a stroke
- have liver problems
- have kidney problems or require dialysis
- have retinitis pigmentosa, a rare genetic (runs in families) eye disease
- have stomach ulcers
- have a bleeding problem
- have a deformed penis shape or Peyronie's disease
- have had an erection that lasted more than 4 hours
- have blood cell problems such as sickle cell anemia, multiple myeloma, or leukemia

Can other medications affect CIALIS?

Tell your doctor about all the medicines you take including prescription and non prescription medicines, vitamins, and herbal supplements. CIALIS and other medicines may affect each other. Always check with your doctor before starting or stopping any medicines. Especially tell your doctor if you take any of the following:

- medicines called nitrates (See "What important information should you know about CIALIS?")
- medicines called alpha blockers. These include Hytrin® (terazosin HCl), Flomax® (tamsulosin HCl), Cardura® (doxazosin mesylate), Minipress® (prazosin HCl) or Uroxatral® (alfuzosin HCl).
- ritonavir (Norvir®) or indinavir (Crixivan®)
- ketoconazole or itraconazole (such as Nizoral® or Sporanox®)
- erythromycin
- other medicines or treatments for ED

How should you take CIALIS?

Take CIALIS exactly as your doctor prescribes. CIALIS comes in different doses (5 mg, 10 mg, and 20 mg). For most men, the recommended starting dose is 10 mg. CIALIS should be taken no more than once a day. Some men can only take a low dose of CIALIS because of medical conditions or medicines they take. Your doctor will prescribe the dose that is right for you.

- if you have kidney problems, your doctor may start you on a lower dose of CIALIS.
- If you have kidney or liver problems or you are taking certain medications, your doctor may limit your highest dose of CIALIS to 10 mg and may also limit you to one tablet in 48 hours (2 days) or one tablet in 72 hours (3 days).

Take one CIALIS tablet before sexual activity. In some patients, the ability to have sexual activity was improved at 30 minutes after taking CIALIS when compared to a sugar pill. The ability to have sexual activity was improved up to 36 hours after taking CIALIS when compared to a sugar pill. You and your doctor should consider this in deciding when you should take CIALIS prior to sexual activity. Some form of sexual stimulation is needed for an erection to happen with CIALIS. CIALIS may be taken with or without meals.

Do not change your dose of CIALIS without talking to your doctor. Your doctor may lower your dose or raise your dose, depending on how your body reacts to CIALIS.

Do not drink alcohol to excess when taking CIALIS (for example, 5 glasses of wine or 5 shots of whiskey). When taken in excess, alcohol can increase your chances of getting a headache or getting dizzy, increasing your heart rate, or lowering your blood pressure.

If you take too much CIALIS, call your doctor or emergency room right away.

What are the possible side effects of CIALIS?

The most common side effects with CIALIS are headache, indigestion, back pain, muscle aches, flushing, and stuffy or runny nose. These side effects usually go away after a few hours. Patients who get back pain and muscle aches usually get it 12 to 24 hours after taking CIALIS. Back pain and muscle aches usually go away by themselves within 48 hours. Call your doctor if you get a side effect that bothers you or one that will not go away.

CIALIS may uncommonly cause:

- an erection that won't go away (priapism). If you get an erection that lasts more than 4 hours, get medical help right away. Priapism must be treated as soon as possible or lasting damage can happen to your penis including the inability to have erections.
- vision changes, such as seeing a blue tinge to objects or having difficulty telling the difference between the colors blue and green.

These are not all the side effects of CIALIS. For more information, ask your doctor or pharmacist.

How should CIALIS be stored?

- Store CIALIS at room temperature between 59° and 86°F (15° and 30°C).
- Keep CIALIS and all medicines out of the reach of children.

General Information about CIALIS:

Medicines are sometimes prescribed for conditions other than those described in patient information leaflets. Do not use CIALIS for a condition for which it was not prescribed. Do not give CIALIS to other people, even if they have the same symptoms that you have. It may harm them.

This leaflet summarizes the most important information about CIALIS. If you would like more information, talk with your healthcare provider. You can ask your doctor or pharmacist for information about CIALIS that is written for health professionals.

For more information you can also visit www.cialis.com, or call 1-877-242-5471.

What are the ingredients of CIALIS?

Active Ingredient: tadalafil

Inactive Ingredients: croscarmellose sodium, hydroxypropyl cellulose, hypromellose, iron oxide, lactose monohydrate, magnesium stearate, microcrystalline cellulose, sodium lauryl sulfate, talc, titanium dioxide, and triacetin.

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Literature revised November 24, 2003

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Globalization Is Great—Sort Of

THE WORLD IS FLAT A Brief History of the Twenty-First Century
Thomas L. Friedman; Farrar, Straus & Giroux; 488pp; \$27.50

Did Thomas L. Friedman have an epiphany halfway through writing his new book? I imagine him jumping into a taxi at Washington National Airport after a visit to Bangalore and finding a laid-off American software engineer behind the wheel. After listening to Friedman gush about the wonders of a flattening earth—the author's term for technology-driven globalization—he hands him a résumé. "I'll take just about anything in tech," says the overeducated cabbie. "I'm not desperate."

This is just my imagination, of course. But the first half of *The World Is Flat: A Brief History of the Twenty-First Century* is a feel-good paean to the ingenuity of man, while the second half—like the story of our taxi driver—is tinged with despair. Friedman, columnist for *The New York Times*, neatly sums up the explosion of digital-technology advances during the past 15 years and places the phenomenon in its global context. Just consider that the Web, search engines, digital photography, iPods, e-mail, PDAs, the browser, file sharing, Wi-Fi, and a dozen other cutting-edge technologies have not only come to dominate economics and the workplace but have also helped reshape the political world—all in less than a generation. Change has been so rapid and overwhelming that there hasn't been time to keep track of the developments, much less to understand their implications. The world is flattening, Friedman says—meaning it is increasingly interconnected. This can raise the poor from poverty, nourish a worldwide middle class, and even spread democracy. Apparently blessed with unlimited travel funds, Friedman sits in innovation centers throughout Asia and America, talking to the seers of silicon—from Netscape co-founder Marc Andreessen to Vivek Paul, president of Wipro, the Indian software company—to discern the meaning of it all. Friedman's conclusion: "Technology determinism" is the force that will rule the economy, just as Charles Darwin's natural selection rules biology. This same technological determinism will also dictate which people in America keep a job and which ones see their work outsourced to Bangalore or Shanghai.

This leads to part two of Friedman's book, wherein hope for a bright technological future goes dim. Half of the world—Africa, much of Latin America, and rural areas of India and China—isn't flattening at all. These places are impoverished, disease-ridden, and without prospects. Because of them, globalization could wind up "like a rocket

that takes off but quickly falls back to earth for lack of sustained thrust."

The long-term outlook for America isn't so great either, Friedman allows. India's specialized technology institutes are turning out battalions of software wizards. China is producing armies of engineers and scientists. They are all eager to work for wages that would violate labor standards in the U.S. but provide a nice middle-class income in their countries. Meanwhile, the fiber-optic cables that certain American companies obligingly laid across the Pacific Ocean shortly before going bankrupt are making it a snap to send offshore the jobs of accountants, software writers, radiologists, illustrators, journalists (gulp), and just about anyone else whose work is knowledge-based.

Oddly, Friedman so badly wants to see all the nifty techno-change as a positive force that, when he contemplates the effects on American jobs and wages, he says his mind keeps telling him: "Ricardo is right, Ricardo is right, Ricardo is right." Friedman is alluding to David Ricardo, the 18th century British economist who came up with the theory of comparative advantage, which should assure Americans of some kind of meaningful work. In theory.

Friedman's ambivalence prompts him to visit the oracles of the major think tanks of Washington, and he concludes that the savior for our unemployed software engineers is... education. The solution, which Friedman likens to JFK's goal of putting a man on the moon, "is to put every American man and woman on

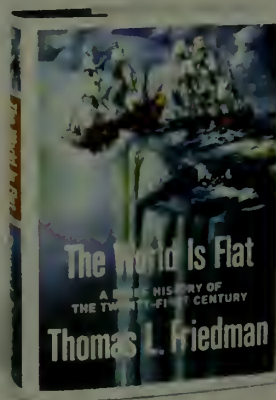
campus." The problem is that more and more PhD grads in the sciences and engineering are foreigners who increasingly return home to write our software and design the next killer app.

So what, realistically, can be done? One of the better solutions is wage insurance, an excellent idea that has been

kicking around Washington for a while. It would supply displaced workers starting on a new job with a year or so of income supplement. In today's flattened economy, it's possible for skilled workers to find new jobs, after all—just not ones that pay as much. Friedman calls this expansion of the safety net "compassionate flattening."

To be fair, I wouldn't think of skipping one of Friedman's op-ed columns in the *Times*. He never shrinks from the biggest problems and the thorniest issues. *The World Is Flat* is no less ambitious. At the least, our imaginary laid-off cab driver can reassure himself that he's hardly alone. ■

—By Paul Magnusson



A planet half impoverished may not be able to get e-connected

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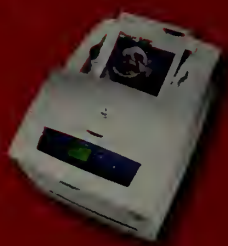
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JAMES C. COOPER & KATHLEEN MADIGAN

Dil Prices Shouldn't Stall This Growth Engine

Domestic demand is strong enough to keep the expansion going

U.S. ECONOMY Is the 2005 economy headed for a spring break like that of 2004? The cause of last year's second-quarter soft patch can be summed up in three words: oil, oil, and oil. Spiking energy prices curtailed growth, especially for consumer spending. Now the worry is another slowdown, given that the average gasoline price hit a record

28 per gallon in the week ended Apr. 11.

However, the economy this year is in much better shape than it was last year. First of all, consumers are benefiting from stronger job markets. Second, the financial markets are easily absorbing the series of Federal Reserve tightenings, and long-term interest rates are lower now than they were last May and June. Finally, the business sector is more willing to spend than it was in the past. One aspect of the latest oil spike is that businesses are using energy costs as a reason to raise prices generally. Business will play a much bigger role in the expansion this year thanks to better pricing power across more industries.

All this is not to imply that costlier oil isn't negatively affecting the economy. It is. Weaker-than-expected March retail sales, along with recent consumer-confidence measures and surveys of businesses, suggest that higher energy bills are curbing some optimism and spending plans. And in coming weeks additional data for March and April could show a bit of softness. Higher oil prices are also contributing to the widening of the U.S. trade deficit, which by itself probably subtracted at least one percentage point from growth in the first quarter.

It is worth noting, though, that although crude-oil prices have been on an upward climb for a year, the U.S. economy managed to grow almost 4% in the same period. Moreover, by mid-April, oil was sharply below its recent peak of \$57. The key here is that the new round of price hikes comes at a time when overall demand is firmer and more widespread than at any previous point in this expansion. Shocks usually cannot derail a well-balanced and growing economy. Struggling economies are more at risk. Just look at the euro zone (page 32).

D POLICYMAKERS took note of the U.S. economy's momentum during their Mar. 22 meeting. In the minutes, released on Apr. 12, the Fed discussed the strength of U.S. demand and its potential effect on inflation.

The minutes said strong income gains and higher health care are supporting consumer spending, which is on track to post another healthy advance in the first quarter. Business spending on equipment, outside of cars, seemed to be growing briskly last quarter, the Fed noted,

adding that the positive outlook for business investment could be attributed to steadily rising sales, an ongoing need to replace and upgrade software and equipment, and favorable financing costs. Inventory building probably also contributed to growth in the first quarter. Overall, the Fed's staff projected that the economy would most likely grow faster than its long-run potential, a

pace generally accepted to be about 3.5%, both this year and next.

One crucial assumption at the late March meeting was that oil prices would "level out or decline a bit." But some attendees noted that "a significant unwinding of higher energy costs might not be in prospect." Moreover, anecdotal reporting by

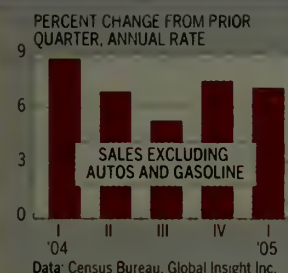
the Fed showed business executives believed robust demand and a weaker dollar meant "a degree of 'pricing power' had returned."

The Fed appears to expect higher energy costs will exert a small degree of pressure on nonenergy prices. But how small will depend on how robust demand remains this spring and summer. If businesses can pass along bigger-than-expected price increases, policymakers would most likely lift interest rates more aggressively.

THAT'S WHY CONSUMER BEHAVIOR in the face of higher energy prices is worth watching. Indeed, the Fed may be expecting higher energy bills to slow consumer spending, as it did last spring. In March, when gasoline prices averaged \$2.08 per gallon, up from \$1.91 in February, retail sales rose only 0.3%, after a 0.5% increase in February. Sales at gas stations jumped 2.1%, almost all due to higher prices. But excluding gas purchases, retail sales still increased 0.1%.

For the entire first quarter, retail sales exclusive of gasoline and autos grew at close to the same pace they did in the fourth quarter (chart). The showing suggests

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BY STEPHEN H. WILDSTROM

So Long to Clunky Web E-Mail

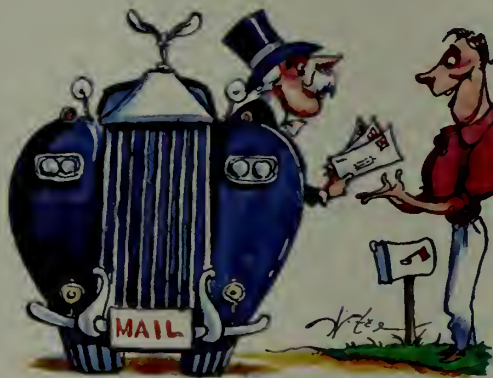
If you have ever had to peruse piles of mail on a Web e-mail program such as Hotmail, or use aol.com to check your America Online messages from work, you know how painful it can be. You don't see a preview of the message text. Paging through a big inbox can take forever. And just moving messages to folders requires multiple steps.

Corporate applications on the Web can be even worse. Used to manage travel and entertainment and other human-resources functions, for example, these programs are often clumsy and slow. Yet companies love them because they're easy and cheap to maintain. Since no software is installed on employees' desktops or laptops, there's no fussing to make sure that every machine has the latest version of the application and all its security patches, and no concerns about compliance with software licenses. It is also much easier to give traveling workers secure access to Web-based programs than to give programs running on their laptops safe access to data behind firewalls.

Thanks to all these advantages, use of Web apps continues to grow, despite their galling limitations. Now there's good news for both consumers and corporate users. The latest Web programs look and perform like traditional desktop programs such as Microsoft Office. The secret is something called rich Internet application technology. It's likely to have a huge impact in the world of business, but some of the first deployments will be in consumer services.

A NEW WEB MAIL PROGRAM from America Online and a forthcoming one from Earthlink show the technology to good advantage. The new AOL Web mail service is superior in some ways to AOL software you install on your PC. In addition to being fast, it shows all your folders in a pane to the left of the message list, and you can move messages simply by clicking on them and dragging them to the appropriate folder. This won't sound like a big deal to users of Microsoft Outlook or other programs that run on your desktop. But it's a big change for Web mail.

The new Earthlink Web mail program, which will be made available to subscribers in June, is a more dramatic step up. The limitations of traditional Web programs often cause them to spawn multiple windows on your screen. That doesn't happen with the Earthlink mail, which bears



a strong resemblance to Microsoft Outlook Express and lets you handle most tasks within a single, multipane window. All your mail appears in a single list that you can scroll through, rather than being broken into pages of 25 or so messages each. You can read the text of a selected message below the inbox list. You can also move messages by dragging them to folders, and you can resize the panes and columns simply by moving the dividers between them.

It will take a while for these richer Web apps to become pervasive, especially in business. Enterprises have invested heavily in older Web-based programs, and with technology budgets tight, they tend to leave alone things that work, even if they are less than optimal. Fortunately, companies such as Laszlo

Finally, Net programs are as supple as desktop software

Systems (which designed the Earthlink mail program) and JackBe provide tools for the rapid conversion of traditional Web programs to rich Internet applications.

Not surprisingly, Microsoft, whose business is based on traditional desktop programs, isn't rushing into rich Internet apps. This is bad news for the large number of mobile workers who reach their corporate mail using the painful Outlook Web Access, which is not due for an overhaul for another 18 months or so. But almost everywhere else, the prospects for Web applications are getting a lot brighter. ■

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BY GLENN HUBBARD

A Free-Market Cure for Japan's Chronic Cold

Japan's economy, a titan of the 1980s, has experienced more than a decade of lost economic growth and might well continue just to limp along. But Japan can expand faster by boosting its productivity. A revitalization of the world's second-largest economy would improve global growth. Two initiatives championed by Prime Minister Junichiro

Koizumi could bring this possibility to life by increasing the effectiveness of Japan's capital markets in allocating savings. They deserve strong U.S. support.

U.S. experience demonstrates how competitive and efficient capital markets can stimulate expansion. The increase in U.S. productivity growth over the past decade is not just a story about information technology. Innovations, while important, are globally available, and America's productivity gains have outstripped those of other countries. Key to the quick adaptation of productivity improvements in the U.S. is capital markets that fund major companies and entrepreneurial upstarts alike. Therein lies the lesson for Japan.

JAPAN IS ALREADY MAKING PROGRESS in corporate restructuring. For example, nonperforming loans—which act as a tax on entrepreneurship by keeping capital from reaching up-and-coming borrowers—have been trimmed. Now Koizumi seeks to promote mergers and acquisitions and privatize the slumbering Japan Post, the state-owned corporation whose savings and insurance arms manage a gargantuan \$3.3 trillion. He has provided crucial economic leadership. But execution is still a challenge.

The M&A debate is really about making management face the discipline of capital markets. Recall the U.S. experience in the late 1970s and early 1980s, in which corporate raiders forced inefficient managers to maximize the value of shares, leading to entrepreneurial wealth creation and greater productivity. Foreign direct investment in Japan—tiny relative to that in China—can jump-start M&A activity. Here is where policy changes are required. The Japanese commercial code must be amended to allow foreign acquirers to pay for acquisitions with stock as well as cash, the practice in most of the industrial world.

Such foreign direct investment is less about hostile takeovers than about friendly acquisitions. There have been some successful high-profile M&A transactions, such as private-equity firm Ripplewood Holdings' restructuring of the Seagaia resort project on the island of Kyushu, Eastman Kodak's acquisition of Chinon Industries, and Wal-Mart Stores' pairing with retailer Seiyu across Japan. These ventures have injected capital into local economies, saved

and created jobs, and added managerial knowhow, calling mind how Japanese investment in the U.S. in the 1980s helped make American companies more competitive. To stimulate M&A in Japan, the Koizumi administration needs to maintain its strong support for allowing cross-border M&A using stock swaps.

Encouraging a competitive market for corporate control is also important. Political opposition is focusing on protecting managers. This recently came to a head when Takafumi Horie, the young boss of Livedoor Co., an Internet-service company, mounted a bid to take over staid Nippon Broadcasting System Inc.

The second potentially transforming policy change is

Two moves by Koizumi could help capital go where it's needed

Koizumi's proposal to privatize Japan Post. Moving the huge assets under its management into private hands could stimulate competition in financial services and productivity, as capital becomes allocated more nimbly and efficiently.

Koizumi wants to split the Japan Post behemoth into separate pieces for mail, bank insurance, and property management. Government ownership (and preferential treatment and state guarantees) would cease by 2017. But

the transition, Japan Post units should fall under the same regulators as their competitors. All advantages accorded Japan Post over its private-sector rivals in insurance and banking should be eliminated as soon as possible.

Reform would allow entrepreneurs such as Horie to thrive. People all over Japan would gain from faster productivity growth and higher incomes. And the global economy would benefit as well. ■

Glenn Hubbard is dean of Columbia Business School. He chaired the Council of Economic Advisers from February, 2003, to March, 2003, and remains an informal White House adviser. (rgh1@columbia.edu).

JAMES C. COOPER & KATHLEEN MADIGAN

Oil Prices Shouldn't Stall This Growth Engine

Domestic demand is strong enough to keep the expansion going

U.S. ECONOMY Is the 2005 economy headed for a spring break like that of 2004? The cause of last year's second-quarter soft patch can be summed up in three words: oil, oil, and oil. Spiking energy prices curtailed growth, especially for consumer spending. Now the worry is another slowdown, given that the average gasoline price hit a record

2.28 per gallon in the week ended Apr. 11.

However, the economy this year is in much better shape than it was last year. First of all, consumers are benefiting from stronger job markets. Second, the financial markets are easily absorbing the series of Federal Reserve tightenings, and long-term interest rates are lower now than they were last May and June.

Finally, the business sector is more willing to spend than it was in the past. One aspect of the latest oil spike is that businesses are using energy costs as a reason to raise prices generally. Business will play a much bigger role in the expansion this year thanks to better pricing power across more industries.

All this is not to imply that costlier oil isn't negatively affecting the economy. It is. Weaker-than-expected March retail sales, along with recent consumer-confidence measures and surveys of businesses, suggest that higher energy bills are curbing some optimism and spending plans. And in coming weeks additional data for March and April could show a bit of softness. Higher oil prices are also contributing to the widening of the U.S. trade deficit, which by itself probably subtracted at least one percentage point from growth in the first quarter.

It is worth noting, though, that although crude-oil prices have been on an upward climb for a year, the U.S. economy managed to grow almost 4% in the same period. Moreover, by mid-April, oil was sharply below its recent peak of \$57. The key here is that the new round of oil-price hikes comes at a time when overall demand is surdier and more widespread than at any previous point in this expansion. Shocks usually cannot derail a well-balanced and growing economy. Struggling economies are more at risk. Just look at the euro zone (page 32).

FED POLICYMAKERS took note of the U.S. economy's momentum during their Mar. 22 meeting. In the minutes, released on Apr. 12, the Fed discussed the strength of U.S. demand and its potential effect on inflation.

The minutes said strong income gains and higher wealth are supporting consumer spending, which is on track to post another healthy advance in the first quarter. Business spending on equipment, outside of cars, seemed to be growing briskly last quarter, the Fed noted,

adding that the positive outlook for business investment could be attributed to steadily rising sales, an ongoing need to replace and upgrade software and equipment, and favorable financing costs. Inventory building probably also contributed to growth in the first quarter. Overall, the Fed's staff projected that the economy would most likely grow faster than its long-run potential, a

pace generally accepted to be about 3.5%, both this year and next.

One crucial assumption at the late March meeting was that oil prices would "level out or decline a bit." But some attendees noted that "a significant unwinding of higher energy costs might not be in prospect." Moreover, anecdotal reporting by

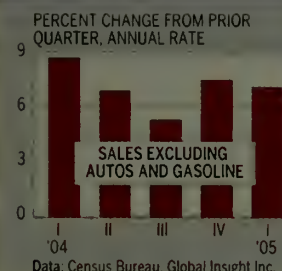
the Fed showed business executives believed robust demand and a weaker dollar meant "a degree of 'pricing power' had returned."

The Fed appears to expect higher energy costs will exert a small degree of pressure on nonenergy prices. But how small will depend on how robust demand remains this spring and summer. If businesses can pass along bigger-than-expected price increases, policymakers would most likely lift interest rates more aggressively.

THAT'S WHY CONSUMER BEHAVIOR in the face of higher energy prices is worth watching. Indeed, the Fed may be expecting higher energy bills to slow consumer spending, as it did last spring. In March, when gasoline prices averaged \$2.08 per gallon, up from \$1.91 in February, retail sales rose only 0.3%, after a 0.5% increase in February. Sales at gas stations jumped 2.1%, almost all due to higher prices. But excluding gas purchases, retail sales still increased 0.1%.

For the entire first quarter, retail sales exclusive of gasoline and autos grew at close to the same pace they did in the fourth quarter (chart). The showing suggests

RETAIL SALES HELD UP LAST QUARTER



real consumer spending on all goods and services increased at an annual rate in the neighborhood of 3.5% for the quarter. Such a vigorous pace supports the forecast that real gross domestic product expanded by about 3.5% last quarter.

Why is energy exerting less of a drag on consumer spending this time around? One reason is that \$2-a-gallon gas no longer carries the sticker shock it once did. Also, as the Fed noted, consumer finances and the outlook for the labor market are much rosier now than a year ago.

For instance, the unemployment rate was a half-point higher in March, 2004, than the 5.2% hit in March, 2005, with 2.1 million more jobs created over the past year. Real aftertax income is growing at a solid 3.3% from its year-ago levels. In addition, households are getting more cash back from Uncle Sam. For tax returns certified by Apr. 8, refunds are averaging \$2,189. That's up 4.7% from the comparable 2004 period. Those larger checks will let consumers cover their higher energy bills and still spend for other goods and services.

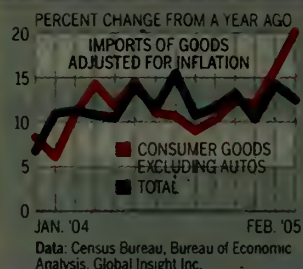
ONE AREA WHERE OIL should exert a continued drag is the trade sector. The U.S. monthly trade deficit hit another record in February, rising to \$61 billion, from \$58.5 billion in January. Higher oil shipments, along with a jump in imports of pharmaceuticals, caused imports to rise 1.6% in February. Exports were virtually flat.

Oil imports surged 10.3% in February. Expect them to rise into the second quarter. That's because February marked only the start of the recent hike in oil prices, and

refiners will be boosting their imports of oil in order to produce gasoline for the all-important summer driving season.

But oil was not all to blame for the worsening trade deficit. Real imports of nonauto consumer goods have gone up over 20% over the past year (chart). One reason

WHERE IMPORTS ARE GROWING THE FASTEST



is the end of quotas on textiles and clothing at the start of this year. Apparel and consumer textile imports rose 14% in the first two months of this year compared with the same period of 2004 while textile jobs in the U.S. dropped by 17,000 in the first quarter, the largest loss in more than a year. Most of the new textiles are probably

being shipped from China, a trend that is contributing to the political tension between that economic powerhouse and the U.S. (page 37).

The bump up in textile imports illustrates a crucial piece of the U.S. economic outlook. Domestic demand is so strong, it is boosting production both in the U.S. and overseas. This solid, broad base of demand is why oil has so far not hampered growth. Unless a surprise supply disruption causes oil prices to skyrocket, the economy should be able to weather the oil-price sequel of 2005. ■

THE EURO ZONE

Why the Central Bank Is in a Straitjacket

AT THE BEGINNING of 2005, growth prospects for the euro zone were not good. Now, owing to this year's oil shock, they're worse. That puts the European Central Bank in a bind.

The ECB would like to start lifting interest rates in an effort to sop up some of the excessive liquidity flowing from the lowest rates since World War II, especially with inflation running just above the bank's 2% target. But even as costlier energy threatens to push inflation higher, it is also hobbling the economy by cutting into consumer spending and raising the cost of doing business.

In a somewhat surprising admission of the economy's weakness, ECB President Jean-Claude

Trichet and other ECB officials strongly hinted after the Apr. 7 policy meeting that the bank had put on hold any intentions to raise its target interest rate from 2%, where it has been for nearly two years, until the economy is solid. Despite an apparent pickup in first-quarter growth from the puny 0.8% annual rate in last year's second half, Trichet said he saw

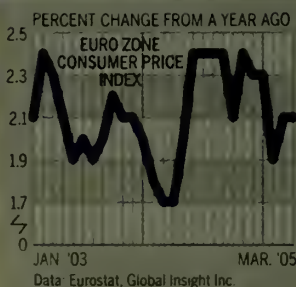
"no clear signs yet of a strengthening in the underlying dynamic" of the economy.

Indeed, recent data show a new slump in activity, especially in manufacturing. German industrial production in February posted the largest drop in two years, and March business surveys in Germany, France, and

Italy show downgraded assessments of current and future production and demand. Companies also said inventories are starting to pile up, and business confidence is waning. Reflecting the latest data and ECB remarks, many economists are cutting their growth forecasts for the spring and summer quarters, and the manufacturing sector might even contract in the second quarter.

To be sure, euro zone inflation is contained, and oil prices are off their peaks. Nevertheless, the danger is that energy costs will remain lofty and push up other prices, which could fuel higher wage demands this autumn. Plus, low interest rates are pumping up home prices in France and Spain, similar to the patterns seen in the U.S. and Britain. The longer the ECB must wait to normalize interest rates, the greater the inflation threat when a solid recovery finally does take hold. ■

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WATCHDOGS WITH EYES WIDE SHUT

As investigators pore over the books of AIG, it's becoming clear that for years regulators failed to detect lapses

BY MIKE McNAMEE

WHERE WERE THE watchdogs? State and federal investigators are examining the accounts of insurance giant American International Group Inc., drawing out super-investor Warren E. Buffett, and sparring over Fifth Amendment rights with ousted AIG Chairman and CEO Maurice R. "Hank" Greenberg. But the feverish enforcement activity obscures the fact that AIG's admitted misstatements—so far worth, by the company's estimate, \$1.7 billion to shareholders—and other industry transgressions went undetected by many of the same agencies, in some instances for 14 years or longer.

What's emerging from the probes is a

portrait of failed regulation. Unlike banking or Wall Street, which answer to federal regulators, the \$1.2 trillion insurance industry is overseen by small, usually obscure state offices. Outgunned by the insurance giants, state commissioners, interested in pleasing voters, usually focus on such consumer issues as setting rates and taking complaints on auto and homeowners' insurance. Many admit that they're out of their depths on sophisticated financing deals with off-shore reinsurers, like those that fogged AIG's books and snarled Berkshire Hathaway Inc.'s General Re Corp. subsidiary in disputes from Memphis to Melbourne. "State regulators are doing the best they can, but they're not equipped to police multistate or international scams," says Jay Aughtman, a

Montgomery (Ala.) lawyer who represents insurance regulators in Tennessee and other states.

GATES LEFT OPEN

OTHER GUARDIANS also failed. Outside auditors didn't penetrate AIG's structure to detect supposedly independent reinsurers that AIG now says it secretly controlled, or hidden side agreements between insurers. Nor did the financial industry specialists who reviewed the insurers' filings at the Securities & Exchange Commission. More broadly, rulemakers at the Financial Accounting Standards Board failed to provide clear, enforceable standards for reinsurance deals. That left the way clear for insurers to polish their financial image with deals that appeared to meet technical tests but in fact had no business purpose

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Losing steam



or were improperly portrayed, such as AIG's \$500 million reinsurance pact with General Re.

UNDER FIRE

Greenberg after refusing to answer probers' questions

In this vacuum, the task of cleaning up insurance has fallen to the SEC's Enforcement Div. and New York Attorney General Eliot Spitzer. They summoned Buffett to New York to testify as a witness on Apr. 11. The next day, they hauled in Greenberg after Spitzer refused to delay his deposition. Greenberg invoked his right to avoid self-incrimination and refused to answer more than 100 questions—including naming the company he'd headed for nearly 40 years.

State regulators defend the job they've done. The problem, they say, is that insurers lied to them. "AIG has acknowledged misleading the New York State Insurance Dept. several times," says Acting New York State Superintendent of Insurance Howard Mills. "We take those transgressions very seriously."

Regulatory sources say that the New York department tangled with AIG in 1996 over Coral Re, a reinsurer that state authorities contended was secretly controlled by AIG. Since 2000, they say, the department has had an ongoing probe of suspect claims on AIG's financial statements. After the Coral Re dispute, these sources say, AIG pledged in writing to reveal any ties with its reinsurers—and filed statements certifying the independence of specific companies that it now acknowledges controlling or backing. "When there's lying of this magnitude—in annual reports, everywhere—it's no different than any other financial debacle," says one regulator.

UPPER HAND

STILL, CRITICS CONTEND that the fragmented system of state regulation lacks the checks that can expose frauds before they compound. In some states, insurers have the upper hand: They dominate state legislatures, keep commissioners on tight budgets, and maintain a revolving door between the commissioner's office and insurers' headquarters. "The general pattern is that the industry makes sure regulators don't have very much clout," says Joseph M. Belth, professor emeritus of insurance at Indiana University.

States do examine insurers for financial solvency—but often miss the big picture. They can't uncover financial weaknesses in affiliated companies, especially those based offshore. "Regulators are interested in the licensed insurer doing business in their states," says Mark Puccia, managing director, financial services at Standard & Poor's, a credit-rating agency owned (like



Who Should Watch the Insurers?

AIG's surprise revelations of \$1.7 billion in accounting misstatements and other recent insurance scandals exposed gaps in regulation. Two possible solutions:

REPLACE THE STATES WITH THE FEDS Multinational insurers easily outgun the 51 separate insurance commissions in the states and District of Columbia. In many states, a revolving door connects industry and regulators. Commissioners focus more on consumer issues such as auto and homeowner rates and concede that they're out of their league with complex business insurance deals. Critics argue that a federal Office of Insurance Regulation in the Treasury—or an independent agency like the Fed—with more clout and a stricter financial focus is needed to deal with sophisticated insurers.

PATCH UP THE CURRENT SYSTEM Neither Washington nor the states is ready to scrap state regulation. Instead, the current players will face pressure to improve their oversight. State commissioners will try to increase coordination through their national association. Accounting regulators will clarify rules for reinsurance deals and off-balance-sheet accounting. Auditors will come under stricter scrutiny and be held responsible for ensuring that deals serve as true insurance. The SEC will also have to step up review of insurers' financials.

BusinessWeek) by The McGraw-Hill Companies. To coordinate efforts, state regulators have banded together in the National Association of Insurance Commissioners. But the NAIC doesn't regulate or investigate. Instead, it proposes laws and rules that states are free to adopt or ignore. The recent focus on reinsurance as a tool for earnings management has spurred NAIC to set up a task force, but it has met only twice. "We need to do more," says NAIC President-elect Alessandro A. Iuppa, Maine's insurance superintendent.

The obvious solution: national regulation. State oversight of insurers is a relic of 19th century finance, until recently defended by insurers. Now, however, the industry is splitting. Many big underwriters crave the uniformity and cost savings of replacing 50 regulators with one. A dual sys-

tem—modeled on banking—has been under discussion for decades: Small insurers would be chartered by states; big insurers would answer to a federal regulator, most likely in the Treasury Dept. Meanwhile, the Federal Reserve Board would continue to oversee financial companies that mix insurance with other businesses.

Problem is, even if today's Republican White House and Congress created a new regulator—a big if—they would be unlikely to give it tough powers like those the SEC enjoys with brokers and banks. The furthest GOP leaders may go now is the so-called SMART bill drafted by House Financial Services Committee Chairman Michael G. Oxley (R-Ohio), which would create a super-NAIC with federal help to press for uniform, streamlined state regs.

Further revelations might force action

ve other big reinsurers, including Swiss Re, MBIA, and St. Paul Travelers, ve disclosed that the SEC and Spitzer ve subpoenaed records from them. here's a lot more to come" on insurance companies collaborating to buff up ch others' financials, warns a source ose to the probes.

SUSPECT SIDE DEALS

IT EVEN ABSENT A strong new federal agency, current watchdogs can do ore. The SEC must use its broad authority to review filings of public companies to focus on insurers' financial reporting until it's confident the industry is cleaned up its act.

Auditors, too, must become more vigilant. The suspect reinsurance deals at G bear an eerie resemblance to Chew Investments LP, the LJM partnerships, and other "special purpose entities" that brought down Enron. Like the Es, the reinsurers AIG used were supposed to be independent—but were in ct closely linked to the parent company. Why didn't such deals arouse more suspicion? In both cases, auditors focused narrowly on whether the deals met technical benchmarks to qualify for favorable treatment, without looking at whether they made sense. Just as important, auditors need to force into the open any side deals that soften or negate the terms of contracts. Such deals already violate insurance and accounting regs, but that hasn't stopped their use.

Accounting-rule writers must also ove faster to clarify standards for "structured finance"—a category that includes off-balance-sheet SPEs and the white reinsurance that AIG allegedly sed to beef up its numbers. FASB is on its third round of post-Enron clarifications for rules governing off-balance-sheet financing. Rulemakers must also et reinsurance standards that genuinely measure risks insurers transfer.

Insurance is a devilishly complicated business, and the industry often plays by o-holds-barred rules. "Insurance is like the Wild West—it makes Wall Street seem quite orderly and gentlemanly," says an analyst. It's also an increasingly sophisticated industry in which players take advantage of every international loophole available to move operations offshore in order to decrease scrutiny and cut tax liabilities. In this high-stakes business, regulators can't afford to be caught napping. When they snooze, investors lose. ■

—With Nanette Byrnes, Diane Brady, and Marcia Vickers in New York

ECONOMIC POLICY

NO MORE MR. NICE GUY WITH CHINA?

Washington is likely to step up pressure on Beijing to revalue its currency

EVER SINCE THE TERRORist strikes of September 11, 2001, the Bush Administration has stressed cooperation, not confrontation, in its dealings with China. Eager to secure Beijing's help in combatting terrorism and trying to defuse the nuclear threat posed by North Korea, the Administration played down concerns over China's mercantilist policies and its ballooning trade surplus with the U.S.

That may be about to change. Infused by a new lineup of officials at the Treasury and State Depts. and facing mounting pressure from Congress and Wall Street over the soaring global trade deficit, the Bush team is taking a fresh look at U.S. relations with China. What's likely to emerge, some officials say, is a more aggressive approach toward the Asian giant that places a higher premium on righting the lopsided trading ties between the two countries. Among the possible options: stepped-up pressure on Beijing, both bilaterally and multilaterally, to let its undervalued currency rise, and increased use of U.S. trade laws to counter damaging increases in imports from China. The Administration already took a step down that path on Apr. 3, when it launched an investigation into whether to re-impose

quotas on surging imports of Chinese clothing following the end of a global textile pact last year.

To be sure, no one is talking about a return to the early days of the Bush Administration, when the President called China a "strategic competitor" and the two countries were at loggerheads after a U.S. reconnaissance plane collided with a Chinese fighter jet sent to intercept it. Indeed, Washington and Beijing agreed on Apr. 13 to the formation of a global issues forum to try to coordinate their efforts in a wide range of areas from the environment to infectious diseases.

Administration officials admit they have limited leverage in pushing China on the currency and trade fronts, given how interdependent the two countries' economies have become. "It's tricky," says one senior official. "They do hold \$200 billion of our Treasury bonds." There's also the risk that aggressive action against China could backfire and lead to an escalating economic dispute. Responding to Congressional calls that Beijing revalue its currency, Chinese Foreign Ministry spokesman Qin Gang told reporters on Apr. 7 that the U.S. should look at correcting its own policies, including its big budget deficit, if it wants to narrow its global trade gap. And in what some U.S. officials see as a snub, China decided against sending its senior economic officials to the Apr. 16-17 meeting of the International Monetary



TOUGH TALKERS The State Dept.'s Robert Zoellick and Treasury's Adams

Fund and World Bank in Washington.

But that hasn't stopped some in the Administration from thinking that it may be time for a different approach. After all, they say, it's not clear that the strategy of cozying up to China has yielded much in the way of benefits. During the 2004 Presidential election campaign election, the Bush team eschewed tough anti-China rhetoric even though that would have played well in such key swing states as Ohio and Michigan. The aim: to give China time to prepare its economy and financial system for a change in its rigid currency peg.

Yet the election has come and gone and the U.S. has yet to see the payoff from its go-easy approach that some in the Bush camp hoped for. Despite two years of quiet economic diplomacy by Treasury, Beijing shows scant signs of acceding to the substantial revaluation of its currency that many experts reckon is needed to rein in its bulging trade surplus with the U.S., which rose 30% in 2004, to \$162 billion.

At the same time, China has not made the sort of progress U.S. State Dept. officials hoped for in dealings with North Korea. Combine that with recent saber-rattling by China over Taiwan—it passed a law last month authorizing an attack should Taipei declare independence—and the communist nation's continued double-digit increases in defense spending, and Washington has less reason to overlook its trade disputes with Beijing.

EXTERNAL PRESSURES

NEW PERSONNEL COULD make the difference in deciding what the U.S. stresses in its relations with China and how it goes about achieving its aims. Officials say the accession of former U.S. Trade Representative Robert B. Zoellick to the No. 2 post at the State Dept. ensures that economic issues won't get short shrift there. While not known as a hard-liner, "there's never been a Deputy Secretary of State with the knowledge of trade that he has," says National Association of Manufacturers Vice-President Frank Vargo.

At the Treasury Dept., former Bush

TEXTILE DECISION The U.S. could reimpose quotas on imports from China

campaign official Tim Adams is also expected to take a tougher line toward China and its currency peg than did his predecessor, outgoing Under Secretary for International Affairs John B. Taylor. "He's much more hawkish on China," says a former U.S. official who knows both men. "He also has a different style." Adams has more of a background in financial markets from his days as a market consultant than the academic Taylor. And he has closer ties to the White House, which could give him added clout within the Administration.

External pressures also argue for a tougher U.S. approach. So far, America's skyrocketing trade deficit with China and the rest of world has not caused any disruptions in the world financial markets. But the bigger the global gap gets—it rose 25% to a record \$617 billion last year—the greater the risks. That was the message U.S. investors delivered to George W. Bush's National Economic Council Director Allan B. Hubbard at a private meeting earlier this year. The investors, including some top hedge funds, urged the Administration to act quickly to reduce the U.S. trade deficit, par-

ticularly with China, or risk a debilitating dollar collapse.

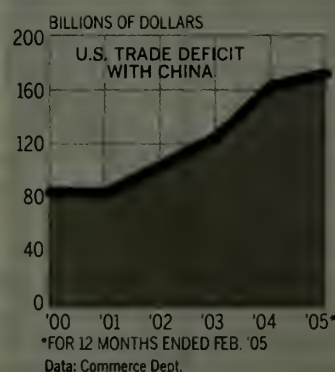
'SEA CHANGE'

CONGRESS, TOO, IS agitating for a tougher stance. On Apr. 6, the Senate, by a 67-33 margin, took China to task for using its cheap currency to fuel exports by refusing to kill a proposal to slap huge import tariffs on Chinese goods if Beijing didn't adjust its exchange rate. Analysts say the bill, which is vigorously opposed by the Administration, is highly unlikely to become law. But, as Senator Lindsey O. Graham (R-S.C.), co-sponsor of the bill notes, the vote shows "a sea change in the way the Senate looks at China." Adds Charles E. Schumer (D-N.Y.), Graham co-sponsor of the bill: "This is a shock across the bow not only to China, but to the Administration."

The Bush team is listening. Given the increasing irritation in Congress and the swelling trade deficit with China, the Administration team may have little choice but to ratchet up its pressure on Beijing and hope for the best.

—By Rich Miller and Stan Crock, with Pat Magnusson in Washington and Dexter Roberts in Beijing

CHINA DAYS



BY EMILY THORNTON

Lazard's IPO May be Hazardous

But the prospectus is so mind-bending, it's hard for investors to tell

YEARS OF embarrassing controversies over convoluted financial reports should have taught companies and their legions of advisers to keep their messages to investors simple. Instead, some seem determined to make shareholders' lives complicated. Like Lazard. ¶ On Apr. 1 the storied 157-year-old investment bank led by brash dealmaker Bruce

Wasserstein filed detailed plans to collect about \$1 billion from investors by going public. But the prospectus raises almost as many questions as it answers. The combination of Lazard's complex ownership structure and its apparent efforts to continue to be taxed as a partnership are problematic. The 205-page main filing also doesn't come clean until halfway through whether the firm has made money after paying its managing directors. "This is one of the most complicated things I've ever seen," says Robert Willens, accounting analyst at Lehman Brothers Inc. Through a spokesman, Wasserstein and Lazard declined to comment, citing Securities & Exchange Commission restrictions ahead of stock offerings.

To be sure, coming up with a clear prospectus for a bank like Lazard is a challenge. It is one of the world's most secretive and byzantine investment banks. And unlike at other banking partnerships that have gone public, such as Goldman, Sachs & Co., some Lazard partners plan to leave pronto. Indeed, Wasserstein wants to go public in part to buy out Chairman Michel David-Weill, a son of the firm's founding family, and his close associates, to end a feud over the bank's direction.

Still, some experts see Lazard's mind-bending prospectus as part of a troubling trend. Instead of using the occasion of going public as a chance to simplify operations, many companies, real estate investment trusts, and limited partnerships are making themselves more impenetrable than ever. "People are saying the corporate structure doesn't give us the protection it used to," says Kathleen Smith, principal of independent Renaissance Capital, which researches initial public offerings. "They are looking for structures that reduce their taxes

No wonder the filing is such a slog: The firm itself is byzantine



TRENDSETTER? Like Wasserstein, others plan complex public offerings

and their liabilities, and it is making the filings more complex."

In Lazard's case, investors will need to keep a close eye on several moving parts. Outside shareholders will have just one-third of the voting rights in Lazard Ltd., a public company specializing in corporate advice and asset management. In turn, that company will own only one-third of a private holding company called Lazard Group. Lazard's managing partners will keep control of both businesses as well as a separate, privately owned business that will make investments and underwrite stocks. What's more, Lazard's senior bankers will get 85% of a windfall in expected tax

savings that could be as much as \$1.7 billion. The savings, which the firm hopes to reap after buying out David-Weill and his associates, will go to a private holding company called LAZ-MD Holdings controlled by Lazard's 207 managing directors.

Lazard also thinks it has figured out a way to outsmart Uncle Sam. Most investment banks pay a 35% rate in federal taxes. But Lazard expects to continue to be taxed at an overall 28% rate. That's because it hopes to be treated as a "publicly traded partnership," though it concedes that the Internal Revenue Service may disagree. If Lazard prevails, "certain income will escape corporate taxation in the U.S.," says Willens. In Bermuda, where Lazard is incorporated, companies don't pay taxes on income, the prospectus notes. Even if that changes, a Bermudian Finance Ministry official confirms, Lazard will be exempt until 2016.

Of course, if Lazard doesn't make money, that will be moot. Wasserstein and David-Weill have squabbled for months over the wisdom of hiring star bankers and whether the bank, with roots in the American gold rush, is profitable or not. Lazard admits that if it includes its managing directors' compensation, the firm lost money in each of the last three years—but not until the middle of the prospectus. "I wish they would have been more forthcoming," says Alan Johnson, a veteran Wall Street compensation consultant.

Add it all up, and investors had better be real comfortable with Wasserstein's stewardship before they get involved in his next excellent adventure as the CEO of a public company. Eventually, the market will sort through the confusing details of the prospectus and value Lazard accordingly. Wasserstein has built a career by defying gravity. But this could be one rocky liftoff. ■

PHARMACEUTICALS

WHEN PATIENTS SAY: DON'T BAN MY DRUG

Emotional lobbying can keep a treatment on the market despite serious side effects

ANYONE WHO THINKS Food & Drug Administration forums are eye-glazing recitations of scientific data should read the transcripts of the Apr. 10 hearings on silicone gel breast implants. The U.S. banned the implants for most uses in 1992, and the FDA is considering whether to allow them back on the market. An advisory panel considered the inconclusive scientific data and then listened to more than 12 hours of emotional testimony, both pro and con, from some 150 women who have tried the implants. The next day the panel members voted by a narrow 5 to 4 margin to recommend against approval.

Now the FDA must weigh in with a final decision. Dr. Caroline A. Glicksman, a plastic surgeon in Sea Girt, N.J. who wants the ban lifted, called on the agency to base its decision "on facts, not politics and emotion." In an ideal world that might happen. But outspoken patients can be a potent force, heavily influencing whether a drug or medical device stays or is pulled from the market. Hundreds or even thousands of individuals frequently lobby the FDA for a



given product—even one with life-threatening side effects—because they believe it is the only thing that works for them.

That puts the agency in a difficult spot. Although it's under pressure from Congress to be more diligent about policing

serious drug side effects, the FDA is also besieged by patients eager to take such risks. Besides visits from silicone-implant proponents, FDA panels have recently heard from patients who want Cox-2 arthritis drugs such as Celebrex or Vioxx, which can hike the risk of heart disease because they think the drugs are the only way to ease their pain. Others want access to AstraZeneca PLC's lung-cancer drug Iressa, believing it will shrink their tumors, though it has limited benefit and is linked to a deadly lung infection.

AT ODDS WITH THE WATCHDOGS

FDA ADVISERS who listen to such pleas say they usually give more weight to the

data. Still, notes Dr. Alastair J.J. Wood, associate dean at Vanderbilt University School of Medicine in Nashville, "Patient testimony can really be quite moving." Wood chaired the FDA panel that considered whether the Cox-2 drugs Bextra, Vioxx, and Celebrex should be pulled. The panel recommended that they be left on the market, but with much stronger warning labels—a common way of balancing safety and patient demands. Only Pfizer Inc.'s Bextra was pulled from pharmacy shelves, on Apr. 7.

Patients keep lobbying meanwhile, because they know it can work. The classic case is GlaxoSmithKline PLC's Lotronex, for irritable bowel syndrome (IBS), a painful but non-life-threatening condition. The drug was suspended in 2000 when it was linked to a gastrointestinal illness that killed five people. After receiving thousands of letters from patients demanding Lotronex' return, the FDA allowed it in 2002, albeit with many restrictions. "It was clear from the letters we got that Lotronex was life-altering for these patients," says Theresa A. Toigo, director of the FDA's Office of Special Health Issues.

Such lobbying often puts patients at odds with watchdog organizations meant to look after their interests. The consumer group Public Citizen labeled the Lotronex decision "a serious public health mistake," and it is just as opposed to the Cox-2 drugs, Iressa, and silicone implants. "Patient pleas are of interest, but they have to be put in the perspective of other data," says Dr. Sidney M. Wolfe, director of Public Citizen's Health Research

Eager to Take the Risk

DRUG	DISEASE	STATE OF PLAY
LOTROXEN GlaxoSmithKline	Irritable bowel syndrome	After intense patient lobbying, the FDA allowed it to return to the market in 2002, albeit it with many restrictions
IRESSA AstraZeneca	Lung cancer	Conditionally approved in 2003, but disappointing results in follow-up studies could lead FDA to pull it this summer
COX-2 DRUGS Pfizer, Merck	Arthritis	FDA pulled Bextra in April because of increased heart-disease risk—but left Vioxx and Celebrex on market with stiff warnings
TYSABRI Bioten-Iddec/Elan	Multiple sclerosis	Suspended after possible link to three cases of deadly brain disease, but many patients say they'll take that chance

group. On the other side, says Michael Franzino, head of patient-advocacy group Psoriasis Cure Now: "I err on the side of patient empowerment."

When the data backing up a drug aren't very compelling, patient empowerment can be the deciding factor. Lung-cancer victims who testified at the initial Iressa hearings made a big impact, even

though the drug shrinks tumors in only 10% of patients. Iressa was conditionally approved in 2003, but follow-up studies failed to show it extends life.

The FDA is expected to make a final decision about both Iressa and silicone implants soon. After that, patients are likely to lobby for other drugs, including Tysabri, a powerful multiple-sclerosis treatment re-

cently suspended because three patients developed a deadly brain infection. The FDA's mailroom workers had better brace themselves for a flood of letters. ■

—By Catherine Arnst in New York

BusinessWeek online For a related story on silicone implants, please visit us online at businessweek.com/extras



PHARMACEUTICALS

'Off-Label' Drugs: J&J Is Pushing the Envelope

Regina Massaro, a nurse practitioner with South Bay Cardiovascular Associates in West Islip, N.Y., is something of an evangelist for Johnson & Johnson's drug Natrecor. Developed by J&J's Scios unit, the drug was approved in 2001 by the Food & Drug Administration for the short-term treatment of heart-failure patients who are having serious problems breathing.

Massaro believes the drug may be helpful to a broader range of patients. Indeed, her boss, Dr. Larry M. Altschul, was one of the first to use Natrecor longer-term to treat patients with heart failure—an experimental therapy known as an "off-label" use of the drug because the FDA did not specifically approve it for such treatment. And Massaro says that Scios has paid to send her to meetings with doctors and nurses around the country six times in the past two years to talk about heart-failure management. Because FDA regulations ban the promotion of such off-label uses, she can't bring up the subject of chronic Natrecor therapy herself.

But Massaro says she frequently gets questions on that topic—and under the rules she is then free to discuss her experiences. "I do get asked about it a lot because we are the ones who pioneered it," Massaro says.

By many accounts, longer-term use of Natrecor is growing. Despite questions about whether the drug could harm kidney function, and whether it could be linked to a higher mortality rate (BW—Apr. 11), Natrecor is expected to rack up nearly \$700 million in sales this year. While no evidence has surfaced that Scios has broken the rules when it comes to marketing, the company has made moves, including the meetings by South Bays' Massaro, that prompt discussion of the drug's off-label uses.

In a statement, Scios says it is marketing Natrecor according to its approved label. The company is conducting trials looking at whether the drug might help people when given on a regular, weekly basis. Yet Scios says its people are not promoting that use—and the FDA has "communicated with them that they shouldn't," says a top agency official.

Certainly, using drugs in ways not

CLINIC Massaro and Altschul see benefits in wider use of Natrecor

spelled out on their label is widespread—and often proper. Frequently drugs are studied for one

condition, then physicians discover other benefits. South Bay's Altschul says he has treated 148 patients with chronic infusions of Natrecor over the past three years and has seen it cut down on hospitalizations and improve quality of life. But in the absence of full data from a large trial studying longer term infusions, the evidence so far is largely anecdotal.

In fact, others in the industry have gotten into hot water in recent years for overly aggressive marketing of off-label uses. In 2004, Pfizer agreed to pay more than \$400 million to settle a case involving off-label promotion by a company it acquired. Yet despite such penalties, companies know that there is a lot of wiggle room in the current rules. For example, drugmakers are barred from pitching doctors directly on unapproved uses of their drugs. But if a doctor or nurse hears about an off-label use and asks a sales representative or someone like South Bay's Massaro about it, those questions are permitted to be addressed.

There are other ways that companies can stimulate buzz about a drug. Drugmakers often sponsor continuing medical education (CME) sessions where off-label uses can be debated. A few CMEs funded by Scios in the past few years have included information on weekly infusions of the drug.

A J&J spokesman says the company knows the general topics of the CMEs it funds, and it may have some input on speakers for those sessions. But he says the company does not control the content. However, Dr. Steven Nissen, a cardiologist at the Cleveland Clinic who was also part of the FDA panel that recommended approval of Natrecor, contends the discussion of off-label uses in CMEs clearly encourages physicians to consider those treatments. In short, those messages may be fueling the growth of an increasingly controversial drug.

—By Amy Barrett in Philadelphia, with John Carey in Washington

THE INTERNET

INTEL'S WIMAX: LIKE WI-FI ON STEROIDS

The chipmaker's ultrafast technology could transform the broadband landscape

WHEN HOLLYWOOD digerati took in the documentary *Rize* at the Sundance Film Festival in late January, they got a glimpse of the future. The movie, about dancers from the mean streets of Los Angeles, was streamed wirelessly to a mountaintop ski lodge from an Intel Corp. server 12 miles away. The technology behind the public-relations stunt: Intel's much-promoted WiMax—a kind of Wi-Fi on steroids. As the documentary flickered across a big screen, the impressive feat of seamlessly delivering gobs of compressed data over the air wowed the audience nearly as much as the movie did.

Intel is gearing up for WiMax' world premiere. As early as Apr. 18, the company will start turning out a new generation of chips that it hopes will turn WiMax into the Next Big Thing in the wireless Web. Thanks to Intel's outsize market power, analysts expect a range of WiMax services to spring up over the next few years, offered by everyone from biggies such as SBC Communications and Comcast to minnows such as Clearwire Technologies, founded in 1998 by cellular pioneer Craig C. McCaw. If WiMax takes off, it could transform broadband by bringing high-speed service to millions more people around the globe, allowing Web surfers to roam at will and cutting subscription rates as new players pile into the market. Says Intel Executive Vice-Presi-

dent Sean M. Maloney: "People have moved from disbelief and skepticism about the technology to being intrigued about its prospects."

Since the late '90s, techies have dreamed of beaming high-speed Internet over the airwaves. Several companies attempted to launch precursors to WiMax but never got off the ground. The infrastructure was too costly, and the competing technologies suffered a lack of common standards.

Now along comes Intel, which aims to duplicate its successful Wi-Fi strategy. In 2003 the chipmaker rolled out its Centrino line of Wi-Fi chips, a move that helped bring the wireless home network to tens of millions. In that case, Intel used its market clout to convince its core customers—PC makers—to adopt Centrino as a standard.

With WiMax, Intel has had no such advantage. It had to bring on board telecom companies, which aren't traditionally Intel customers: They're the ones who will sell the service. So the chipmaker created a WiMax forum with such heavyweights as SBC, Sprint, and Nokia to hammer out common standards for its chips. To start with, WiMax, which Intel says will be up to six times faster than existing broadband service in the U.S., will

WHO NEEDS DSL?

In Florida, quick downloads via Clearwire

be used to bring high-speed Internet to homes and businesses that lack service

But in a couple of years, WiMax will go mobile, allowing people to download movies, games, and other content without being tethered to a local hot spot, as Wi-Fi requires.

Having developed the WiMax standard, Intel seems to have stolen a march on rivals like Fujitsu. The early lead could win the Santa Clara (Calif.) chipmaker the lion's share of a market that could be worth \$20 billion by 2015, according to communications analyst Erik Zamkoff of Independent Research Group. Moreover, Intel's planned rollout of combination Wi-Fi/WiMax chips in 2007 will likely spur consumer and business upgrades of everything from notebooks, tablets, and other mobile devices to routers—all of which could contain other Intel

processors and memory chips.

HELP FOR UPSTARTS

FOR CONSUMERS, WiMax could shake up the broadband world by helping to eliminate the cable and DSL duopoly that dominates the market. That could lead to lower prices and higher speeds. Upstarts could use WiMax to break cheaply into incumbents' markets. Clearwire, for example, has introduced a precursor to WiMax in four cities in Florida,

Texas, and Minnesota, and hopes to use Intel's technology to add 16 more cities by yearend.

Big players will be able to enter each other's territories, too. For example, in February a Verizon Communications Inc. subsidiary, Verizon Avenue, began offering a WiMax-like service in Monterey, Calif., a market currently served by rival SBC. Time Warner Inc., Comcast Corp., and other cable providers could make use

of WiMax to deliver content outside the home. That would provide competition for cellular providers, some of which also aim to sell WiMax services alongside existing high-speed mobile networks.

However fierce the new round of competition WiMax sets off, consumers are likely to enjoy it. ■

—By Cliff Edwards in San Mateo, Calif.

THE STAT

\$20 BILLION

Estimated value of worldwide WiMax equipment market by 2015

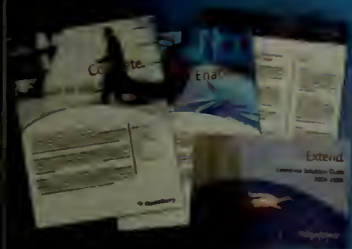
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ADVERTISING

SHORT ON SIZZLE, AND LOSING STEAM

Y&R's clients and execs have defected.
Are Ann Fudge's days numbered?

FOR ANN FUDGE, JAGUAR could have been a chance to redeem the sagging reputation of Y&R, the flagship ad agency of marketing services giant Young & Rubicam Brands. When Jaguar's \$150 million global account came up for review last fall, incumbent Y&R teamed up with sister agency Red Cell, both units of WPP Group PLC, to keep the business. But Fudge, chairman and CEO of both Y&R and its parent company, skipped the all-important first meeting, which rival CEOs attended. Fudge says the top brass at Jaguar, a subsidiary of Ford Motor Co., knew she wouldn't be coming and that "it wasn't an issue." But her absence, along with the mediocre impression left by her team, prompted the carmaker to take the agency out of the running before ultimately awarding the job to Euro RSCG Worldwide in February. "It was an unfortunate way for Y&R to behave considering we still have three other brands at the agency worth much more than Jaguar," says a top Ford executive.

The loss was another stinging defeat in what has been a rough period for the ex-Kraft Foods Inc. marketing star. Since taking over two years ago, Fudge has presided over a string of high-profile defections of execs and clients, including Burger King, Computer Associates International, Sony Electronics—and Kraft.

The turmoil has fueled widespread in-

dustry speculation that Fudge's days atop Y&R are numbered. In an exclusive interview with *BusinessWeek*, Fudge conceded that she and WPP are looking for someone to replace her as the head of the agency, though she'll remain in charge of the parent, which also includes PR agency Burson-Marsteller, branding powerhouse Landor Associates, and direct marketer Wunderman. WPP CEO Martin Sorrell says that under Fudge, "Y&R Brands is strengthening," and Fudge insists the shift was always intended. "I want to focus on the whole marketing communications company," she says. Still, two senior WPP execs see her likely exit as a prologue to her leaving altogether.

Fudge's lack of ad experience made her a controversial choice to revive Y&R when she took the job in May, 2003. Although at Kraft she rejuvenated such brands as Kool-Aid and Maxwell House, many questioned if she had the connections and feel to revive the moribund agency. Y&R insiders say she erred in focusing on productivity and "thinking like a client" rather than on the culture needed to inspire creativity. Clients say they have not been wowed by Y&R's campaigns, while the tendency to shun agencies seen to be in

decline has added to Y&R's woes.

With Fudge having taken a two-year break from corporate life between Kraft and Y&R, many insiders also wondered if she had the drive to make it in the ad

The Fudge Factor

Gaps in the Y&R chief's skill set

EXPERTISE A marketing icon at Kraft, Fudge hasn't figured out the eccentric, personality-driven ad world

CREATIVITY A pragmatic focus on Six Sigma productivity and client needs has left some troops uninspired

LEADERSHIP Insiders call her "warm and laid back" when "aggressive and hungry" is what they want

STILL UPBEAT
Fudge says new talent has made a difference

world. Nor have her marketing savvy and renowned people skills been enough to repair a culture ripped apart by Y&R's stormy re-

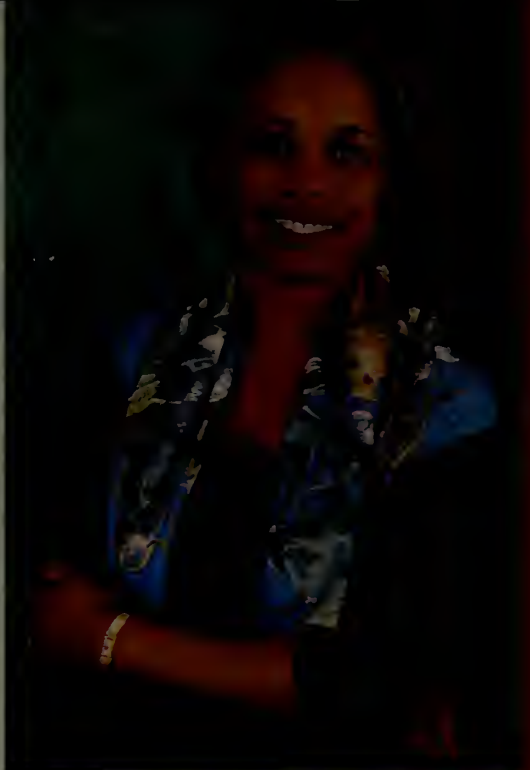
cent past: Following a public offering in 1998 and a WPP takeover two years later, many senior execs cashed out.

HEADING FOR THE EXITS

WHILE FUDGE ARGUES that the agency is already benefiting from an influx of new talent and a broader mindset that has "moved beyond the 30-second ad," it's hard to put a positive spin on her record. New accounts such as Toys 'R' Us and Weight Watchers don't make up for those lost, though WPP doesn't break out separate numbers for the group. Moreover, she has lost key talent, including recent departures like executive creative director Ann Hayden and William Eccleshare, chairman and CEO of Young & Rubicam Brands in Europe, the Middle East, and Africa. Layoffs and defections have shrunk the New York office alone more than 10%. "This kind of negative momentum is hard to reverse," says a rival agency head. Adds Y&R North America Chief Gord McLean: "There are some things we could have done better."

Fudge argues that more time is needed to fix Y&R. "I knew a turnaround would take three to five years," she says. "Business is starting to come back." Insiders can only hope that Fudge's replacement at Y&R can convince clients to stay put. ■

—By Diane Brady, with David Kiley, in New York





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HEADLINER

GEORGE
SHAHEEN



I LOVE TROUBLE

It has been five years since George Shaheen ran a company, but the Siebel Systems director found himself back on top on Apr. 13, when the board asked him to replace CEO J. Michael Lawrie, who resigned after just 11 months. Shaheen, 60, got beaten up badly the last time he was a boss. He ran online grocer Webvan, which self-destructed in 2001.

Shaheen's rise came one week after Siebel warned it will post a first-quarter loss because of weaker-than-expected software sales. Lawrie had just one bad quarter, but Chairman Thomas Siebel has a history of replacing executives rapidly. Analysts see Siebel as a potential takeover target; the company is besieged by competition—including SAP and Salesforce.com. That's why many think Shaheen's best bet may be to simply find a buyer. But Shaheen insists he's no temporary CEO. "I'm here to continue to build this company," he says.

That would go a long way toward restoring his tarnished name.

—Steve Hamm

BOEING'S BONANZA

A potential deal by Northwest Airlines to purchase up to 18 Boeing 787 jetliners, worth about \$2.1 billion at list prices, could be a blow to the rival Airbus A350 jetliner. Sources say Northwest Airlines, an important Airbus customer, is in final negotiations to buy Boeing's 787, which costs 10% less to fly than similar-size airplanes. Northwest hasn't publicly confirmed the sale. If Northwest buys its first 787, it could force Airbus to rethink the A350. The latest version calls for using the same engines as the 787 and adding more weight-saving composites. But other than Air Europa, no airline has expressed serious interest in the A350. Meanwhile, Boeing has orders and commitments for 203 787s in just 15 months, not including the Northwest deal.

FORD: BAD ROAD AHEAD



Ford Motor investors are bracing for more bad news on Apr. 20 when first-quarter earnings appear. Analysts expect Ford to announce cuts to second-quarter output, on the heels of slashing its 2005 earnings forecast on Apr. 8 by 27%, to a range of \$2.75 billion to \$2.3 billion. Faced with rising steel and oil

prices, soaring health-care costs, and a weak dollar, as well as tough competition, Ford says its auto operations will break even on a pretax basis, at best. CEO William Ford Jr. also admitted Ford will miss his goal of \$7 billion in pretax earnings in 2006.

HACKERS RAISE HACKLES

The odds of a congressional crackdown on loosely regulated information brokers rose with the Apr. 12 disclosure by LexisNexis that thieves may have gained access to personal records of 310,000 individuals—10 times higher than its estimate in March. LexisNexis said it has chronicled 59 instances over the past two years in which criminals may have obtained such data as Social Security numbers. On Apr. 13, lawmakers warned greater oversight may be coming. One idea: a federal law that brokers alert consumers when files are breached—now required only by California.

ALL EYES ON THE BIG BOARD

The New York Stock Exchange isn't out of the woods yet, despite a settlement on Apr. 12 with the Securities & Exchange Commission over the Big Board's alleged failure to prevent trading abuses by member firms. The NYSE, without admitting or denying wrongdoing, agreed to underwrite an outside monitor and to videotape some traders regularly. Federal prosecutors indicted 15 top NYSE traders on charges that they cheated customers. The SEC filed civil fraud charges against the 15 and five other traders for mishandling customer

orders from 1999 through 2003. Moreover, the SEC is probing possible misconduct by current or former NYSE officials who were supposed to detect and punish the abuses, which occurred before the exchange beefed up oversight. The NYSE declined to comment on the ongoing SEC investigation.

ET CETERA...

» Stock-option expensing for most public companies is likely to be delayed until January.

» Apple Computer's quarterly earnings soared 530%.

» Morgan Stanley star bankers Joseph Perella and Tarek Abdel-Meguid quit.

CLOSING BELL

Harley-Davidson shares skidded 17%, to \$48.93, amid slowing growth. Harley plans to make 329,000 bikes this year—up 12,000 from 2004, but 10,000 below earlier estimates. First-quarter profits rose 11% on a 6% jump in sales, but analysts fear a bike glut.



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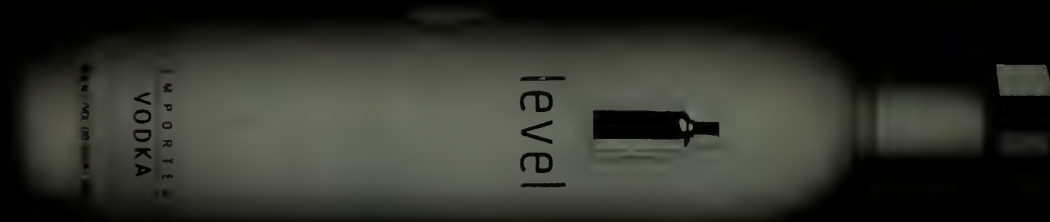
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EDITED BY RICHARD S. DUNHAM

A Pro-Business Pit Bull Sets Some Teeth on Edge

FROM AIG CEO MAURICE R. "HANK" GREENBERG to former Qwest chief Joseph P. Nacchio, the tidal wave of scandal continues to swamp boardrooms across America. But Thomas J. Donohue, CEO of the U.S. Chamber of Commerce, isn't backing off a campaign against what he views as regulators run amok. Amid

the allegations of corporate wrongdoing, the combative lobbyist continues to lash out against the enforcers, warning of a dire threat to U.S. business. "Government agencies have gone overboard" in implementing the Sarbanes-Oxley corporate governance law, Donohue says. "An accounting error could never be seen as a crime."

Donohue's top target for overzealous regulation and heavy-handed enforcement is Chairman William H. Donaldson's Securities & Exchange Commission. Plenty of business leaders privately support his goals, but some lobbyists cringe at Donohue's take-no-prisoners approach. They fear the Chamber is overreaching in ways that could back the campaign to convince investors

at Corporate America has cleaned up its act. "The business community now has no credibility," frets a trade-group lobbyist. Donohue. "For the best-known business organization to take on the SEC in this way doesn't help."

Among those leery of a war on the SEC is the Business Roundtable, which was quick to distance itself from

the Chamber's opposition to a rule that bars companies from selectively disclosing key information to favored investors or analysts. In Mar. 2, then-CEO of AutoZone Inc. Steve Dandland, head of the Roundtable's corporate governance task force, sent a letter to the SEC's five commissioners and its enforcement director lauding the rule, known as Reg FD, for "fair disclosure."

The Chamber is also suing the SEC over a requirement that 75% of a mutual fund's di-

rectors, including its chairman, be independent of the fund's investment adviser. A U.S. appeals court was scheduled to hear oral arguments in the case on Apr. 15. And the Chamber has filed a brief in support of Siebel Systems Inc., a software company the SEC has twice sued for alleged violations of Reg FD. The Chamber says the rule tramples First Amendment guarantees of free speech.

A Head-Scratcher

THE CHAMBER'S SUIT over the fund governance rule, which the SEC adopted last July in a 3-2 vote, has raised eyebrows because few of the group's 100,000 members are fund companies. According to the Chamber, the suit was launched at the behest of a few

big fund-company members that are partially underwriting the challenge, but officials declined to name them. Fidelity Investments, which vigorously opposes the SEC rule, says it discussed its views with the Chamber but hasn't earmarked any of its

Chamber membership dues to pay for it. Fidelity declined to comment about any separate contributions to help pay for the lawsuit.

SEC lawyers insist the mutual-fund rule is on firm legal ground, but some securities experts think the agency may have exceeded its authority. "It's a toss-up," says Diane E. Ambler, a partner at Kirkpatrick & Lockhart Nicholson Graham LLP. If the court sides with the Chamber, it may be too late to write a tighter rule: Two of the three SEC commissioners who voted for the current one could leave this summer. And a victory just might further embolden Tom Donohue. ■

—By Amy Borrus, with Aaron Pressman in Boston



Donohue (right) says Donaldson's SEC is too zealous by half



CAPITAL WRAPUP

THE SEC'S TOP COP: BIG SHOES TO FILL

THE SECURITIES & Exchange Commission's announcement, expected on Apr. 14, that Enforcement Director **Stephen M. Cutler** would soon step down is bound to give investor advocates the jitters.

Cutler, who joined the SEC in 1999 and became its top cop in 2001, has used hardball tactics and stiff penalties to bring hundreds of errant companies, executives, auditors, and other gatekeepers to account.

The 43-year-old Yale Law School grad directed the SEC's cases against Enron, WorldCom, and Qwest, as well as its landmark probe of trading

abuses at the New York Stock Exchange. Prodded by the headline-grabbing investigations of New York State Attorney General **Eliot Spitzer** (page 142), Cutler molded his division into an elite squad that is forcing Corporate America and Wall Street to clean up dodgy finances and conflicts of interest. Joel Seligman, dean of Washington University School of Law, calls Cutler "one of the greatest directors of enforcement in the SEC's history."

The choice to succeed Cutler will send a signal about SEC Chairman Donaldson's commitment to strict policing of securities laws. A leading contender is **Linda Chatman Thomsen**, Cutler's deputy and fellow tough cop.

Will the agency's policing stay strong? Stay tuned

—By Amy Borrus

CHINA

AD AGENCIES UNCHAINED

Soon to be the world's No. 3 ad market, China is easing restrictions on foreign agencies. The jockeying has begun

THE AD CAMPAIGN LEFT shoemaker Nike Inc. flat-footed. The company's "Chamber of Fear" spot featured LeBron James of the NBA's Cleveland Cavaliers battling—and defeating—a computer-generated Kung Fu master. It might not have raised eyebrows elsewhere, but Chinese consumers found the concept insulting, and Beijing banned the ad last December.

The bad news for Nike, though, was great news for advertisers. The fact that the ad ignited a national debate highlighted the growing power of advertising in China. The industry has grown from virtually nothing in 1979, when the communist government lifted a ban on ads, to as much as \$16 billion last year—an increase of at least 20% over 2003, according to MindShare, a media buying company. By next year, China will be the third-largest ad market in the world, and the numbers are predicted to keep climbing as the nation gears up for the 2008 Beijing Olympics.

The potential has international ad agencies scrambling for position. Since the market opened 26 years ago, virtually every major industry player has set up shop in China. Until now they have been confined to operating joint ventures with local partners. That restriction, though, will be lifted at the end of this year under commitments China made when it joined the World Trade Organization. While some agencies have good relationships with their local partners and value the cultural background they provide, others feel constrained by the regulations. The rule change "will be liberating for a lot of [agencies] that have been boxed in with a bad or mediocre partner," says David Droga, global cre-

ative director for Publicis Group, the giant ad agency conglomerate.

International ad agencies control the biggest accounts, but there's plenty of local competition. The country has some 80,000 ad shops doing everything from designing fliers and renting space on local taxis to placing ads on the Internet—and charging cutthroat prices for their services. The best of those agencies—and myriad companies in other industries hungry for experienced marketing hands—are also attracting many of the young Chinese execs that the global giants have schooled. "The biggest problem we have is finding more people to hire and keeping the ones we train," says Shelly Lazarus, chairman of New York-based Ogilvy & Mather Worldwide, which has

1,000 employees in four cities in China.

One challenge for global agencies is tailoring ads to the regional sensibilities of China's 1.3 billion citizens. As the divide between the rich coastal cities and the poorer interior grows, companies must make sure their messages fit the audience. "In Shanghai, where women are more cosmopolitan and sophisticated, we cater to a daily regimen of skin care with Oil of Olay," says Alfonso de Dios, media director for Greater China at consumer goods giant Procter & Gamble Co. "But in Urumqi we sell women Safeguard soap and Crest first. It's a question of needs."

Those concerns have spurred big foreign agencies to seek out local expertise. J. Walter Thompson Co. has taken a 30% stake in Guangzhou's Newsun Insight while O&M bought Fujian Effort Advertising in Fujian Province. And O&M has signed a deal that allows it to tap the 70 million members of the Communist Youth League for market research. "This gives us the arms and legs and geographical reach to do things on the ground that wouldn't be possible unless you had a mammoth network," says Joseph Wang, O&M's vice-chairman for Greater China.

RISING DOMESTIC BILLINGS

WHILE MULTINATIONALS have driven the market until now—P&G's Oil of Olay skin cream was the most advertised brand in China last year—local clients are coming on strong. Last year four local brands were among the top 10 advertisers in China, according to Nielsen Media Research. And J. Walter Thompson gets about 35% of its billings from Chinese companies today, up from zero five years ago, as it has signed up the likes of computer maker Lenovo, cellular carrier China Mobile, and TV manufacturer Konka.

China's industry, though, remains

Big Spenders

Western brands once dominated China's market, but locals are coming on strong

TOP TEN ADVERTISERS IN CHINA IN 2004	(MILLIONS OF DOLLARS)*
Oil of Olay (skin cream)	698
Gai Zhong Gai (calcium tablets)	441
Rejoice (shampoo)	419
Crest (toothpaste)	281
Sanjing Pharmaceuticals	266
China Mobile (cellular)	259
Aoqili (soap)	256
Head & Shoulders (shampoo)	249
Huangjindadang (vitamins)	237
Colgate (toothpaste)	230

*Data: Nielsen Media Research



SUPPLE P&G
tailors its ads
for different
regions

decades behind the West in sophistication and creativity. Sure, well-heeled shoppers ply the luxury boutiques in Shanghai and Beijing, but most Chinese put the highest value on low price and reliability. That means successful ads need a straightforward message that tells the consumer exactly what to expect. That helps explain the tremendous success of products such as Gai Zhong Gai, a brand of calcium tablets. It was the second-biggest spender on advertising in China last year, buying ad time with a list price totaling \$441 million (though most companies receive discounts of up to 50%). Many in the industry pooh-pooh Gai Zhong Gai's simplistic approach and constant repetition of the same message. "They did everything that an advertising textbook in the U.S. would

Chinese culture can flummox Western agencies

tell you not to do, but it worked," says Quinn Taw, managing partner of MindShare. "They created a whole awareness about calcium and bones."

And what works elsewhere in the world doesn't always translate well in China. KFC Corp.

found that Colonel Sanders didn't resonate with consumers, while Nike's "Just Do It" campaign doesn't work because it emphasizes individualistic youthful irreverence—a no-no in Confucian China. Instead, Nike runs ads such as a 10-second spot that features a school kid impressing classmates by spinning the globe on his finger. While the ad expresses playfulness and a certain bravado, "there's no rebellion," says Tom Doctoroff, CEO of Greater China for J. Walter Thompson, which made the spot.

And as Nike's Kung Fu ad shows, campaigns created for China sometimes fall wide of the mark. Toyota had a similar experience with an ad showing a Land Cruiser SUV towing what appeared to be a Chinese military truck, and another featuring stone lions, a traditional symbol of power in China, bowing down to Toyota's Prado GX. Chinese consumers balked at the perceived insult to their armed forces and at the notion of bowing to anything—even a car—representing Japan.

Kung Fu masters. Military trucks. Stone lions. The potential pitfalls are endless. But for the companies trying to make their mark on the mainland, the potential rewards are worth the effort. ■

—By Frederik Balfour in Hong Kong,
with David Kiley in New York



INDIA

THE SOFT UNDERBELLY OF OFFSHORING

A high-tech scam on Citibank accounts is a nightmare for India's call centers

ON THE STEAMY MORNING of Apr. 4 two smartly dressed men walked into a branch of Rupee Co-operative Bank Ltd. in Pune, 100 miles from Bombay. The two were among the city's software and back-office workers—a growing, prosperous group coveted by banks and merchants. But police had asked the branch managers to keep an eye out for suspicious transactions in the duo's bank accounts, and the pair were soon arrested for stealing money from four U.S. customers of Citibank. Both had worked at Citibank call-center contractor Mphasis BFL Ltd., where, police allege, they had persuaded Citi customers to give them passwords and other account details. After quitting Mphasis, police say, the pair logged on to Citi's online system and transferred at least

\$426,000 to their own accounts. So far, 14 people have been arrested in the crime, and about \$230,000 has been recovered. Formal charges are pending, but a lawyer for the two men says they and others implicated in the case will plead not guilty.

TOO MUCH ACCESS

A HIGH-TECH SCAM targeting a top U.S. customer is a nightmare for India's call-center industry. The nation has been riding high on demand from multinationals seeking to cut costs by shipping jobs offshore, and industry revenues are expected to double next year, to \$12 billion. Yet many insiders had lived in fear of the day when some sort of scam was uncovered. Even though there has been relatively little identity theft in India—just two other, small-bore cases are known, compared with hundreds of thousands in the U.S.—industry officials are afraid of a backlash

MPHASIS SUSPECTS Indian officials fear a U.S. backlash against outsourcing

from U.S. opponents of offshoring. "This is a real body blow to our image," admits Mphasis Chairman Jerry Rao. "It doesn't help saying: 'If a customer gives out passcodes, there is little we can do.'"

What the industry can do is beef up its security. Already most companies have strict measures in place to guard customer data. Employees' bags are searched when they enter and leave, and they are forbidden to take cell phones, PDAs—even pens and paper—to their workstations. Some worry, though, that the computer systems of U.S. companies let workers in India see too much sensitive information. For instance, an agent handling loan applications may also have access to a customer's savings account number. "Companies need to strictly restrict access to information among employees on a requirement basis," says Ravindra Datar, an analyst at research house Gartner India.

The problem is that too many workers leave too soon. Attrition in the industry is about 60%. That's the consequence of explosive growth, where companies hire 1,800 newbies every week. In the rush to get fresh recruits to their workstations, rigorous interviewing and quality training are often overlooked, consultants say. The average training period has shrunk to just two weeks from as long as six weeks three years ago.

Despite the widespread concern, the Mphasis incident won't likely derail the industry. Some potential clients will reassess their options, but Citibank, for one, says it's not changing its relationship with Mphasis and has no plans to curtail outsourcing to India. If the industry can keep improving security, it has little to fear in the long term. "This could have happened anywhere," says John C. McCarthy, an analyst at Forrester Research. "The Indians are doing a pretty good job and this shouldn't be viewed as a systematic indictment of their practices." But if the industry can't curb its attrition problem and more such scams turn up, customers could start heading for the exits. That would be a nightmare come true.

—By Josey Puliyyenthuruthel in Bangalore, with David Rocks in New York

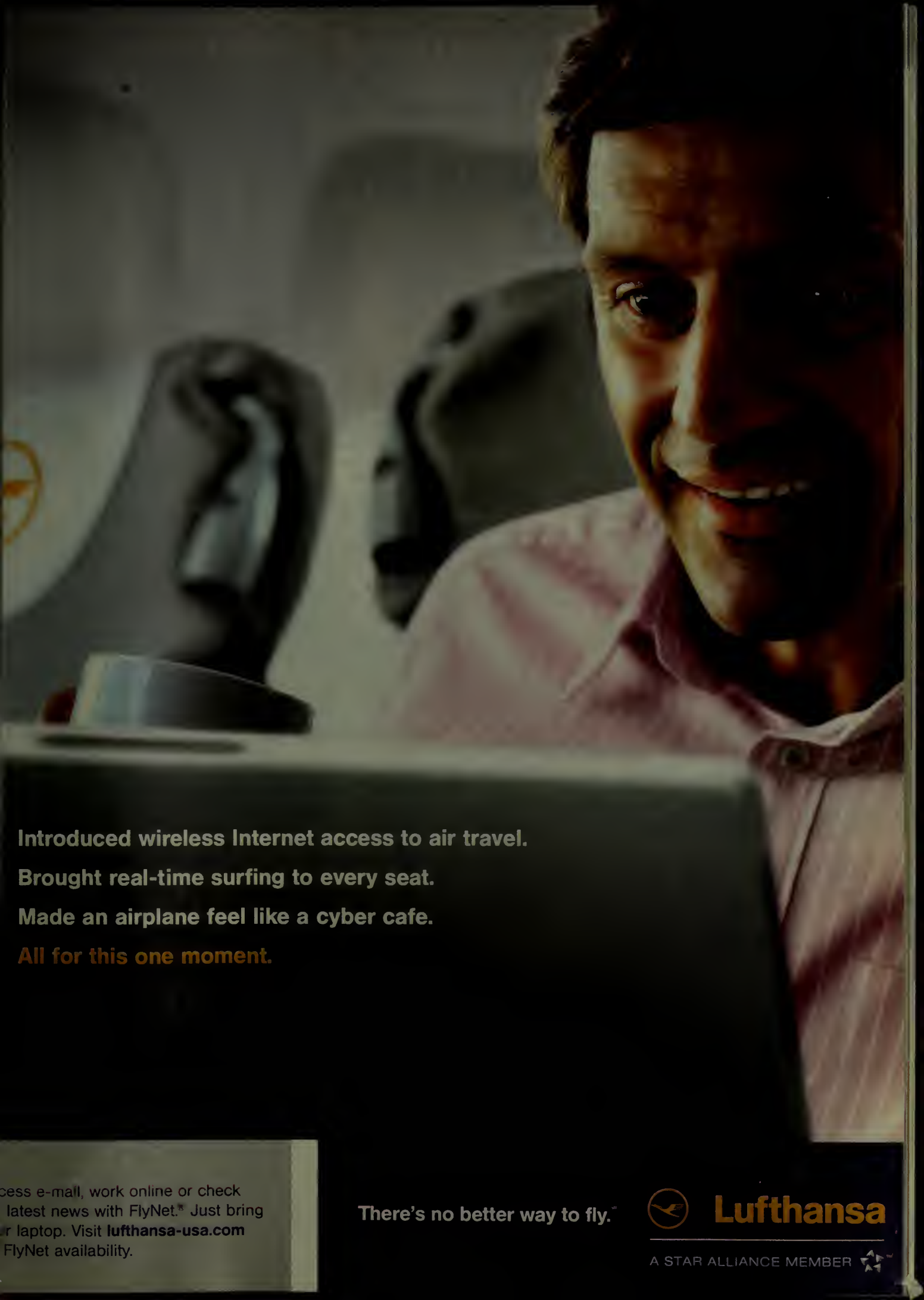
Rip-Off

Here's how police say 14 suspects stole funds from U.S. bank accounts

1 Five Mphasis workers illegally get passwords from four U.S. Citibank customers, then quit the Indian company

2 In December they and nine others start setting up bank accounts using false identification

3 They log on to Citibank online and transfer at least \$426,000 to the Indian accounts



Introduced wireless Internet access to air travel.

Brought real-time surfing to every seat.

Made an airplane feel like a cyber cafe.

All for this one moment.

Access e-mail, work online or check
latest news with FlyNet.® Just bring
your laptop. Visit lufthansa-usa.com
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Lufthansa

A STAR ALLIANCE MEMBER 

FRANCE

WHAT GHOSN WILL DO WITH RENAULT

Nissan's chief aims to use the allied carmakers to rival the global giants

NISSAN CHIEF EXECUTIVE Carlos Ghosn is only 51, but his résumé is already chock-a-block with turnarounds. He has engineered the most dramatic comeback in automotive history at Japan's No. 2 carmaker and restructured French carmaker Renault and tire giant Michelin as well. So what does the unstoppable Ghosn do for an encore? He'll run two auto makers, another industry first. On Apr. 29, Ghosn returns as CEO at \$53 billion Renault, which owns 44% of Nissan, while keeping his CEO spot at \$70 billion Nissan Motor Co. The Renault-Nissan alliance is selling more cars than any company except General Motors, Toyota, and Ford, with a 9.3% global market share, up from 8.9% in 2000. "It's the only alliance in the industry that has worked well," says Michael Raab, an auto analyst at Sal. Oppenheim Jr. & Co. in Frankfurt.

Now comes Phase Two—intensifying cost savings and grabbing more global share. Running two huge carmakers may well be Ghosn's most taxing assignment yet. "It's a massive undertaking," says Jean-François Manzonni, professor of leadership and organizational development at IMD International in Lausanne,

Switzerland, who has written a case study on Nissan. "The risk is Ghosn getting so overworked that he loses his high bandwidth—the ability to process a lot of information rapidly."

FIERCE COMPETITION

THERE WILL BE a lot to process. Renault has become one of Europe's most profitable mass-market carmakers. But Japanese and Korean carmakers are stepping up their attack on Europe's stagnant car market and forcing margins down on everything from mini cars to compact sedans—Renault's core products. Rival Toyota Motor Corp. boosted its European market share to over 5.5% last year, up from 3.7% in 2000. Even French rival PSA Peugeot Citroën has higher plant productivity. Worst of all, PSA and Toyota have teamed up in a joint venture that in



GHOSN A long to-do list awaits him at the French carmaker

March began producing three new minis in the low-wage Czech Republic.

To boost margins, Ghosn must build sales and rev up savings from joint purchasing, development, and platform-sharing with Nissan. The French factory that makes Renault's unsuccessful executive sedan, the Vel Satis, for example, might switch to a midsize sport utility built on a Nissan platform.

Japanese-style quality and efficiency are musts if Renault is to have a shot at reentering the U.S., a goal Ghosn has set for sometime after 2010. Renault lacks distinctive models that would set it apart in the U.S., but analysts say it could develop a new SUV or crossover on a joint platform with Nissan, wielding French design to create a high profile. "It's an opportunity to tap the largest market in the world," says Adam Jonas, auto analyst at Morgan Stanley in London.

Ghosn assumes responsibility for another initiative: rolling out a supercheap car for the masses, the \$6,500 Logan. Built in Romania, India, and Russia, it's Renault's bid to grab more share in emerging markets. Renault forecasts sales of more than 1 million Logans by 2010. Yet even if the car is a hit, the Logan will produce minimal profits.

Minimal profits, of course, are not what Ghosn is all about. An executive who can be both charismatic and ruthless, he did not make his mark by leaving things as he found them. Watch for a shakeup at Renault when the new boss returns for another round. ■

—By Gail Edmondson in Frankfurt, with bureau reports



RENAULT'S VEL SATIS SEDAN

DYNAMIC DUO

The Renault-Nissan alliance is moving up the global rankings



* ALL FIGURES ARE FOR CALENDAR 2004
Data: Company report; Toyo Keizai

* FISCAL YEAR ESTIMATES FOR TOYOTA AND NISSAN
ENDING MAR. 31, 2005

VIAGRA[®]

(sildenafil citrate) tablets



Keep that spark alive.

FACT: Viagra can improve erections for guys with ED. Studies show Viagra can also improve their sexual relationship satisfaction.

Viagra can improve the ability to achieve and maintain an erection for guys with erectile dysfunction. **Ask your doctor if VIAGRA is right for you.**

To learn more, visit viagra.com or call 1-888-4VIAGRA

VIAGRA is prescribed to treat erectile dysfunction. We know that no medicine is for everyone. If you use nitrate drugs, often used for chest pain (known as angina), don't take VIAGRA. Taking these drugs together could cause your blood pressure to drop to an unsafe level.

The most common side effects of VIAGRA are headache, facial flushing, and upset stomach. Less common are bluish or blurred vision, or being sensitive to light. These may occur for a brief time. Remember to protect yourself and your partner from sexually transmitted diseases.

Talk with your doctor first. Make sure you are healthy enough to have sex. If you have chest pain, nausea, or other discomforts during sex, seek medical help right away. Although erections lasting for more than four hours may occur rarely with all ED treatments in this drug class, it is important to seek immediate medical attention. Erections lasting longer than six hours can result in long-term loss of potency.

VIAGRA is covered under most Managed Care Plans.

Please see our patient summary of information for VIAGRA (25 mg, 50 mg, 100 mg) tablets on the following page.

 U.S. Pharmaceuticals

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VIAGRA®

(sildenafil citrate) tablets

This summary contains important information about VIAGRA®. It is not meant to take the place of your doctor's instructions. Read this information carefully before you start taking VIAGRA. Ask your doctor or pharmacist if you do not understand any of this information or if you want to know more about VIAGRA.

This medicine can help many men when it is used as prescribed by their doctors. However, VIAGRA is not for everyone. It is intended for use only by men who have a condition called erectile dysfunction. **VIAGRA must never be used by men who are taking medicines that contain nitrates of any kind, at any time. This includes nitroglycerin. If you take VIAGRA with any nitrate medicine your blood pressure could suddenly drop to an unsafe or life threatening level.**

• What Is VIAGRA?

VIAGRA is a pill used to treat erectile dysfunction (impotence) in men. It can help many men who have erectile dysfunction get and keep an erection when they become sexually excited (stimulated).

You will not get an erection just by taking this medicine. VIAGRA helps a man with erectile dysfunction get an erection only when he is sexually excited.

• How Sex Affects the Body

When a man is sexually excited, the penis rapidly fills with more blood than usual. The penis then expands and hardens. This is called an erection. After the man is done having sex, this extra blood flows out of the penis back into the body. The erection goes away. If an erection lasts for a long time (more than 6 hours), it can permanently damage your penis. You should call a doctor immediately if you ever have a prolonged erection that lasts more than 4 hours.

Some conditions and medicines interfere with this natural erection process. The penis cannot fill with enough blood. The man cannot have an erection. This is called erectile dysfunction if it becomes a frequent problem.

During sex, your heart works harder. Therefore sexual activity may not be advisable for people who have heart problems. Before you start any treatment for erectile dysfunction, ask your doctor if your heart is healthy enough to handle the extra strain of having sex. If you have chest pains, dizziness or nausea during sex, stop having sex and immediately tell your doctor you have had this problem.

• How VIAGRA Works

VIAGRA enables many men with erectile dysfunction to respond to sexual stimulation. When a man is sexually excited, VIAGRA helps the penis fill with enough blood to cause an erection. After sex is over, the erection goes away.

• VIAGRA Is Not for Everyone

As noted above (*How Sex Affects the Body*), ask your doctor if your heart is healthy enough for sexual activity.

If you take any medicines that contain nitrates – either regularly or as needed – you should never take VIAGRA. If you take VIAGRA with any nitrate medicine or recreational drug containing nitrates, your blood pressure could suddenly drop to an unsafe level. You could get dizzy, faint, or even have a heart attack or stroke. Nitrates are found in many prescription medicines that are used to treat angina (chest pain due to heart disease) such as:

- nitroglycerin (sprays, ointments, skin patches or pastes, and tablets that are swallowed or dissolved in the mouth)
- isosorbide mononitrate and isosorbide dinitrate (tablets that are swallowed, chewed, or dissolved in the mouth)

Nitrates are also found in recreational drugs such as amyl nitrate or nitrite ("poppers"). If you are not sure if any of your medicines contain nitrates, or if you do not understand what nitrates are, ask your doctor or pharmacist.

VIAGRA is only for patients with erectile dysfunction. VIAGRA is not for newborns, children, or women. Do not let anyone else take your VIAGRA. VIAGRA must be used only under a doctor's supervision.

• What VIAGRA Does Not Do

- VIAGRA does not cure erectile dysfunction. It is a treatment for erectile dysfunction.
- VIAGRA does not protect you or your partner from getting sexually transmitted diseases, including HIV – the virus that causes AIDS.
- VIAGRA is not a hormone or an aphrodisiac.

• What To Tell Your Doctor Before You Begin VIAGRA

Only your doctor can decide if VIAGRA is right for you. VIAGRA can cause mild, temporary lowering of your blood pressure. You will need to have a thorough medical exam to diagnose your erectile dysfunction and to find out if you can safely take VIAGRA alone or with your other medicines. Your doctor should determine if your heart is healthy enough to handle the extra strain of having sex.

Be sure to tell your doctor if you:

- have ever had any heart problems (e.g., angina, chest pain, heart failure, irregular heart beats, heart attack or narrowing of the aortic valve)
- have ever had a stroke
- have low or high blood pressure
- have a rare inherited eye disease called retinitis pigmentosa
- have ever had any kidney problems
- have ever had any liver problems
- have ever had any blood problems, including sickle cell anemia or leukemia
- are allergic to sildenafil or any of the other ingredients of VIAGRA tablets
- have a deformed penis, Peyronie's disease, or ever had an erection that lasted more than 4 hours
- have stomach ulcers or any types of bleeding problems
- are taking any other medicines

• VIAGRA and Other Medicines

Some medicines can change the way VIAGRA works. Tell your doctor about **any medicines** you are taking. Do not start or stop taking any medicines before checking with your doctor or pharmacist. This includes prescription and nonprescription medicines or remedies:

- Remember, VIAGRA should never be used with medicines that contain nitrates (see *VIAGRA Is Not for Everyone*).
- If you are taking alpha-blocker therapy for the treatment of high blood pressure or prostate problems, you should not take a dose of greater than 25 mg of VIAGRA at the same time (within 4 hours) as you take your dose of alpha-blocker.
- If you are taking a protease inhibitor, your dose may be adjusted (please see *Finding the Right Dose for You*).
- VIAGRA should not be used with any other medical treatments that cause erections. These treatments include pills, medicines that are injected or inserted into the penis, implants or vacuum pumps.

• Finding the Right Dose for You

VIAGRA comes in different doses (25 mg, 50 mg and 100 mg). If you do not get the results you expect, talk with your doctor. You and your doctor can determine the dose that works best for you.

- Do not take more VIAGRA than your doctor prescribes.
- If you think you need a larger dose of VIAGRA, check with your doctor.
- VIAGRA should not be taken more than once a day.

If you are older than age 65, or have serious liver or kidney problems, your doctor may start you at the lowest dose (25 mg) of VIAGRA. If you are taking protease inhibitors, such as for the treatment of HIV, your doctor may recommend a 25 mg dose and may limit you to a maximum single dose of 25 mg of VIAGRA in a 48 hour period. If you are taking alpha-blocker therapy, you should not take a dose of greater than 25 mg of VIAGRA at the same time (within 4 hours) as your dose of alpha-blocker.

• How To Take VIAGRA

Take VIAGRA about one hour before you plan to have sex. Beginning in about 30 minutes and for up to 4 hours, VIAGRA can help you get an erection if you are sexually excited. If you take VIAGRA after a high-fat meal (such as a cheeseburger and french fries), the medicine may take a little longer to start working. VIAGRA can help you get an erection when you are sexually excited. You will not get an erection just by taking the pill.

• Possible Side Effects

Like all medicines, VIAGRA can cause some side effects. These effects are usually mild to moderate and usually don't last longer than a few hours. Some of these side effects are more likely to occur with higher doses. The most common side effects of VIAGRA are headache, flushing of the face, and upset stomach. Less common side effects that may occur are temporary changes in color vision (such as trouble telling the difference between blue and green objects or having a blue color tinge to them), eyes being more sensitive to light, or blurred vision.

In rare instances, men have reported an erection that lasts many hours. You should call a doctor immediately if you ever have an erection that lasts more than 4 hours. If not treated right away, permanent damage to your penis could occur (see *How Sex Affects the Body*).

Heart attack, stroke, irregular heart beats, and death have been reported rarely in men taking VIAGRA. Most, but not all, of these men had heart problems before taking this medicine. It is not possible to determine whether these events were directly related to VIAGRA.

VIAGRA may cause other side effects besides those listed on this sheet. If you want more information or develop any side effects or symptoms you are concerned about, call your doctor.

• Accidental Overdose

In case of accidental overdose, call your doctor right away.

• Storing VIAGRA

Keep VIAGRA out of the reach of children. Keep VIAGRA in its original container. Store at 25°C (77°F); excursions permitted to 15-30°C (59-86°F) [see USP Controlled Room Temperature].

• For More Information on VIAGRA

VIAGRA is a prescription medicine used to treat erectile dysfunction. Only your doctor can decide if it is right for you. This sheet is only a summary. If you have any questions or want more information about VIAGRA, talk with your doctor or pharmacist, visit www.viagra.com, or call 1-888-4VIAGRA.



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September 2002

EDITED BY ROSE BRADY

Why Japan and China Are Squaring Off

FOR YEARS, optimists in China and Japan have argued that peakneck economic integration of the two Asian powers could trump festering historical enmities. After all, last year, China overtook the U.S. as Japan's biggest trading partner, and two-way trade clocked in at \$211 billion. But the Sino-Japanese

strategic rivalry is real, tense, and likely to turn more contentious in the months ahead.

That was underscored early on Apr. 9, when some 5,000 protesters in Beijing clashed with riot police and stormed the Japanese embassy. Protesters accused Tokyo of whitewashing wartime atrocities, such as the 1937 massacre of civilians in Nanjing, in new editions of school history books. The next day, demonstrators in the cities of Guangzhou and Shenzhen trashed Japanese storefronts and called for boycotts of goods ranging from Sony DVD players to Toyota Corolla cars. Even Chinese Premier Wen Jiabao turned up the heat on Apr. 12 when, during a visit to India, he declared that Japan "needs to face up to history squarely."

What's behind the tension is far more than longtime differences over Japan's past aggressions. Japan and China are locked in a fierce contest for economic and diplomatic leadership in Asia. Unable to bolster Japan's economy much since he took office in 2001, Japanese Prime Minister Junichiro Koizumi has increasingly played the nationalist card to shore up support at home and project a more assertive Japan around the world. This has involved everything from controversial visits to the Yasukuni Shrine, where war criminals as well as war dead are commemorated, to proposed constitutional reforms that would allow Japan to take

China has seen since the U.S. accidentally bombed the Chinese Embassy in Belgrade in 1999. "The government probably didn't expect the protests to go [so] far," says Akio Shibata, a China expert and deputy director of the the Marubeni Research Institute in Tokyo.

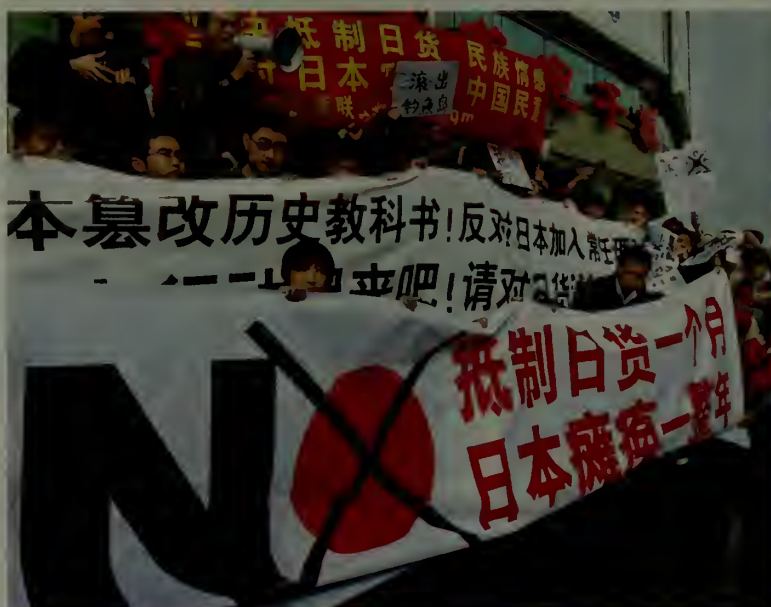
Even if the protest over schoolbooks proves momentary, stress between the two countries will likely continue across a range of fault lines. Koizumi has already blasted Beijing for a submarine incursion into Japanese waters last November, and Japan plans to cut off any new yen development loans to China starting in 2008. Japan is also making preparations to start exploration in a potentially rich natural gas bed in the East China Sea that falls within disputed international waters with China—unless Beijing gets real about settling the flap diplomatically.

One of the sorest points will be the debate over the U.N. Security Council. Japan, the U.N.'s second-biggest contributor, wants to be admitted to the Security Council as part of a major U.N. reform package now under discussion. China, one of the Council's veto-wielding permanent members, opposes expansion of the Security Council—an opposition widely seen as a move to block Tokyo. To Japan's chagrin, even longtime ally Washington is waffling. The Bush Administration is insisting on a "broad consensus" at the U.N. before

signing off. "It is not a slam dunk for Japan or any other country," says one senior Administration official.

The trouble for Koizumi is that all the long-term trends argue in favor of China taking a leadership role in Asia. China's gross domestic product is about one-third the size of Japan's \$4.5 trillion GDP at current exchange rates. But China, with its double-digit growth, seems all but certain to overtake Japan toward the end of the next decade. China's \$30 billion defense budget is growing at a 10%-plus pace and isn't that far off from Japan's current budget of \$45 billion. None of this adds up to harmonious relations between Tokyo and Beijing. And much as it pains the Japanese to admit it, China will increasingly be calling the shots. ■

—By Brian Bremner in Tokyo, with Dexter Roberts in Beijing and Stan Crock in Washington



OLD WOUNDS
Anti-Japanese protests in Beijing

robust military action beyond its borders. The Chinese, feeling their economic and diplomatic influence on the rise, are doing their best to counter Tokyo. "They think enough is enough. And they probably believe they are in a decent position internationally to do this," says Eric Heginbotham, senior fellow for Asia Studies at New York's Council on Foreign Relations.

Fault Lines

WITH SO MUCH at stake economically, neither government wants the situation to spin out of control. Japan's Foreign Minister, Nobutaka Machimura, is expected to travel to Beijing soon for talks. Yet with emotions so high, it will be tough for Koizumi to meet Beijing halfway on textbook reform. Chinese President Hu Jintao & Co. also ran a risk by allowing the anti-Japanese protests—the biggest

Sometimes wanna be your lover / Sometimes wanna be your friend ♪ Jason Smikle couldn't get the song out of his head. A freshman at Temple University, the 19-year-old hummed the tune by hip-hop impresario Ludacris, in the shower, over breakfast, and as he walked to class. On a recent 80-degree day in Philadelphia, he started singing the lyrics while he and a buddy, who had just broken up with a girlfriend, relaxed on the campus quad. His friend whipped out his LG mobile phone, tapped a couple of keys, and presto, the melody wafted into the air. "So cool," Smikle recalls. He only wished he could download the song to his own phone on the spot. "It'd be very cool, when the moment called for it, if I could just get the song," he says.

Jason, your wish may soon be granted. Mobile phones that rock, jam, thunder, and swing are on the way. Wireless operators around the globe are working

iPod Killer

NEW RIVALS TAKE AIM AT THE CHAMP

BY ROGER O. CROCKETT



THE THREAT
People may start
using cell phones
as jukeboxes

with music studios, phone makers, and artists such as Sean "P. Diddy" Combs in a sweeping effort to turn the mobile phone into a go-anywhere digital jukebox. Foreign carriers such as Vodafone and SK Telecom are leading the way, and U.S. wireless players are following fast. *BusinessWeek* has learned that Verizon Wireless, Sprint, and Cingular Wireless are expected to unveil services for downloading music directly to wireless phones later this year. "We have a tremendous opportunity to make a big impact in music," says Dennis F. Strigl, CEO of Verizon Wireless.

With innovative services and snazzier phones, the telecom players figure they can swipe a chunk of the digital music market that Apple Computer Inc. cracked open with its iconic iPod. That sets the stage for a battle between two industries. On one side are Apple and the other tech players concentrated in Silicon Valley that see the computer as central to the future of music. On the other are

How iPod's Phone Rivals Stack Up



iPOD

\$99 to \$449

PLUSES: The most elegant music player on earth. Apple offers three levels of devices—the iPod, mini, and Shuffle—which can store between 120 and 15,000 songs.

MINUSES: This baby doesn't do downloads over the air, make calls, or take pictures.

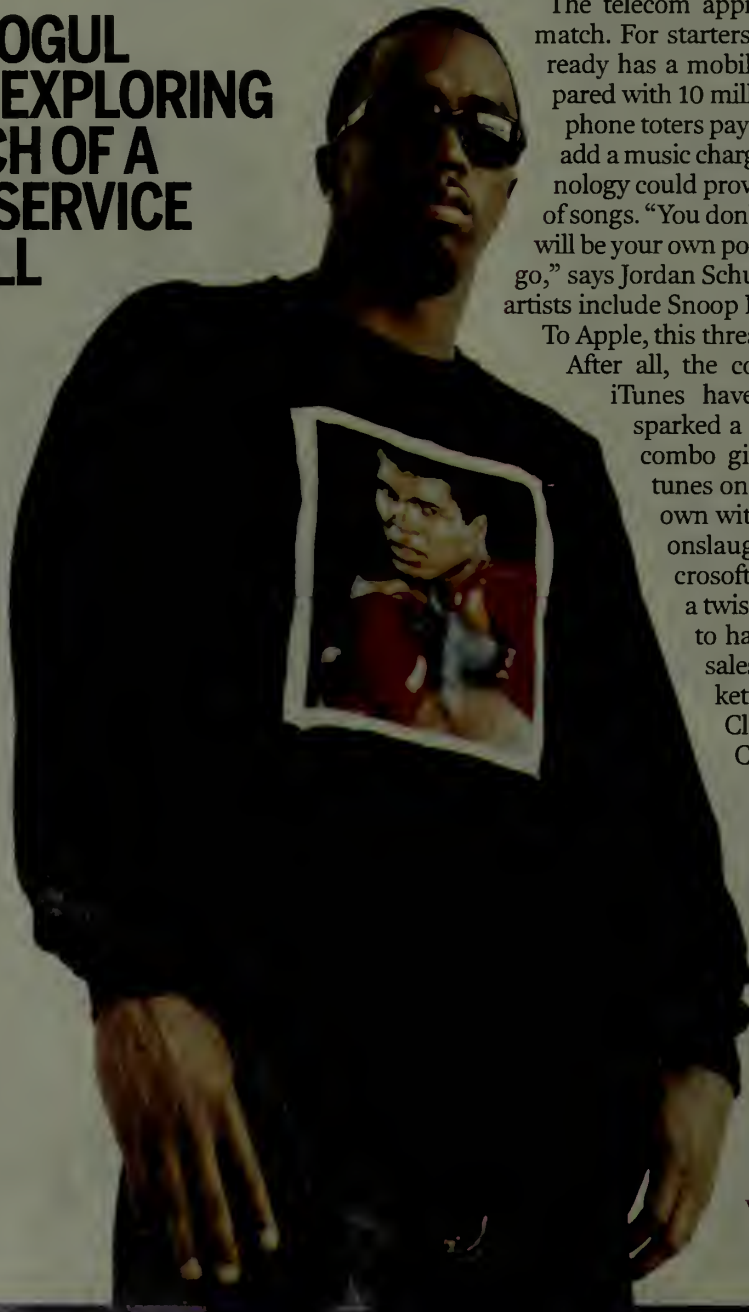


SAMSUNG SGH-4500
\$450 to \$500*

PLUSES: A 3-gigabyte hard drive that can store 1,000 songs, scroll-wheel navigation, and iPod-quality sound.

MINUSES: Won't hit U.S. market until year at the earliest, keypad buttons may be too cramped.

HIP-HOP MOGUL P. DIDDY IS EXPLORING THE LAUNCH OF A WIRELESS SERVICE CHOCK-FULL OF MUSIC



telecom companies, from Finland to South Korea to the U.S. that think the mobile phone can become the center of the emerging world. "The iPod is great," says Frank Nuovo, chief designer for Nokia, the world's largest handset maker. "But no one has a stranglehold. There's nothing that keeps the mobile phone from moving into that area."

The telecom approach has several strengths Apple can't match. For starters, a quarter of the world's population already has a mobile phone. That's 1.4 billion people, compared with 10 million iPods sold to date. Most of those cell phone toters pay a monthly phone bill, making it a snap to add a music charge. Perhaps most important, wireless technology could provide access anytime, anywhere to millions of songs. "You don't have to be a genius to see that the phone will be your own portable stereo that's with you wherever you go," says Jordan Schur, co-president of Geffen Records, whose artists include Snoop Dogg and Garbage.

To Apple, this threat may look more than a little overblown.

After all, the company's elegant iPod and easy-to-use iTunes have been such breakthroughs that they've sparked a musical revolution. The carefully crafted combo gives consumers a no-hassle way to buy tunes on the Net and carry every single song they own with them. Already, Apple has faced a fierce onslaught from the likes of Dell, Sony, and Microsoft, and turned it back with little more than a twist and shout. On Apr. 13, Apple is expected to have announced more than 5 million iPod sales in the latest quarter, building on its market lead. "I absolutely love it," says Michelle Clapp, a 17-year-old student from Saratoga, Calif., who got an iPod for Christmas.

Plus, Apple has learned from the past. Some 20 years ago it lost its lead in the personal computer industry by insisting on complete control over its technology. But Apple has learned from its mistakes and is showing much more flexibility these days. It opened up its iTunes store to people using computers with Microsoft Corp.'s operating system and let partner Hewlett-Packard Co. distribute its own version of the iPod.

Threatened or not, Apple is also trying to play a role in putting music on phones. It's developing an iPod phone with Motorola Inc. that the pair have



SONYERICSSON W800 WALKMAN

\$300*

PLUSES: Funky design, capacity for at least 250 songs, battery life similar to the iPod mini, and sharp 2-megapixel camera.

MINUSES: Can't connect to some online music stores, let alone handle wireless music downloads.

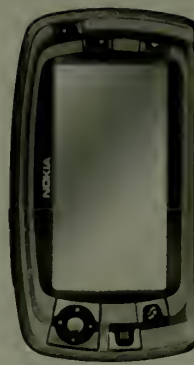


MOTOROLA E680i

\$400 to \$600*

PLUSES: Memory card storage of up to 600 songs, stereo-quality speakers, can handle MP3s and popular music file formats from Microsoft and RealNetworks.

MINUSES: Boring gray design in a clunky shape and a low-quality camera.



NOKIA 7710

\$500 to \$600*

PLUSES: Wide, bright color screen, stores different types of music files, expandable memory can store 300 songs.

MINUSES: No keypad, stylus only. Risk of face sticking to screen during calls.

*Overseas prices. Not available in U.S.

ported marketing to wireless operators. Motorola says it expects at least one carrier will begin selling the phone this summer. If that happens, the carrier would not build its own music store and instead send its customers to iTunes.

But Apple has had a rough start in working with wireless operators. Most major wireless companies, including Verizon Wireless and Sprint, have balked at carrying the iPod phone. That's a serious impediment because the operators essentially control distribution by subsidizing phones. Why the resistance? Operators want customers to download songs over the air, directly to handsets. But with the iPod phone, customers would download songs to a PC and then copy them to the phone. "It's hard for people in any industry to support something that cuts them out of potential future revenue streams," says Graeme Ferguson, director for global content development at Vodafone Group PLC, one of the world's largest wireless players. Apple declined to comment for this story.

The two sides also have very different perspectives on how digital music stores should work. Verizon, Sprint, and Cingular are expected to charge about \$2 for wireless downloads when they introduce their services, or twice the 99¢ per song on iTunes. They figure they can charge a premium for the convenience of listening to songs anytime, even though customers most likely won't be able to listen to those songs anywhere but on their phones, at

least initially. One knowledgeable source close to Apple says the operators are simply being unrealistic if they expect customers to pay \$2 or \$3 for a song, especially with restrictions. "If you can get something for a buck, why would you buy it for \$3?" says the source. "Do they think people are that dumb?"

A Run for the Money

WHAT WILL COME OUT OF all this is not just a battle of sharp words and elbows but also a new round of innovation in digital music. Apple and other MP3 player makers could add wireless technology to their devices or help develop a crop of music phones. As hundreds of millions of mobile devices around the world go musical, there will be an explosion in the possibilities for marketing, distributing, and listening to music. On Apr. 12, Capitol Records Inc. said it would release a hugely anticipated new single by the rock band Coldplay as a ringtone to Cingular wireless customers first, rather than on the radio. Virgin Mobile USA says it's exploring ways to couple wireless music downloads with news clips, lyrics, or even videos from the artist. "A lot of people are paying attention to this new frontier and what its potential can be," says Virgin Mobile CEO Daniel H. Schulman.

International wireless operators provide a sense of what's

Bringing Tunes to the Cell Phone

Apple Computer reigns supreme in selling music downloads over the Net, but wireless operators around the world are moving to stake their claim in digital music. Their secret weapon? Cell phones that are becoming music players. By 2008, half of the 860 million cell phones sold will play music.

RINGTONES MANIA These snippets of songs cost \$1 to \$3 and replace the ring you hear when someone calls. They've become a gold mine. Revenues are expected to reach \$9.4 billion by 2008.

WALLED GARDEN Last year, Europe's Orange and Vodafone began selling complete song downloads for \$2.80. For now, songs can't be moved to another device. U.S. carriers are expected to introduce similar services with slightly lower prices by August.

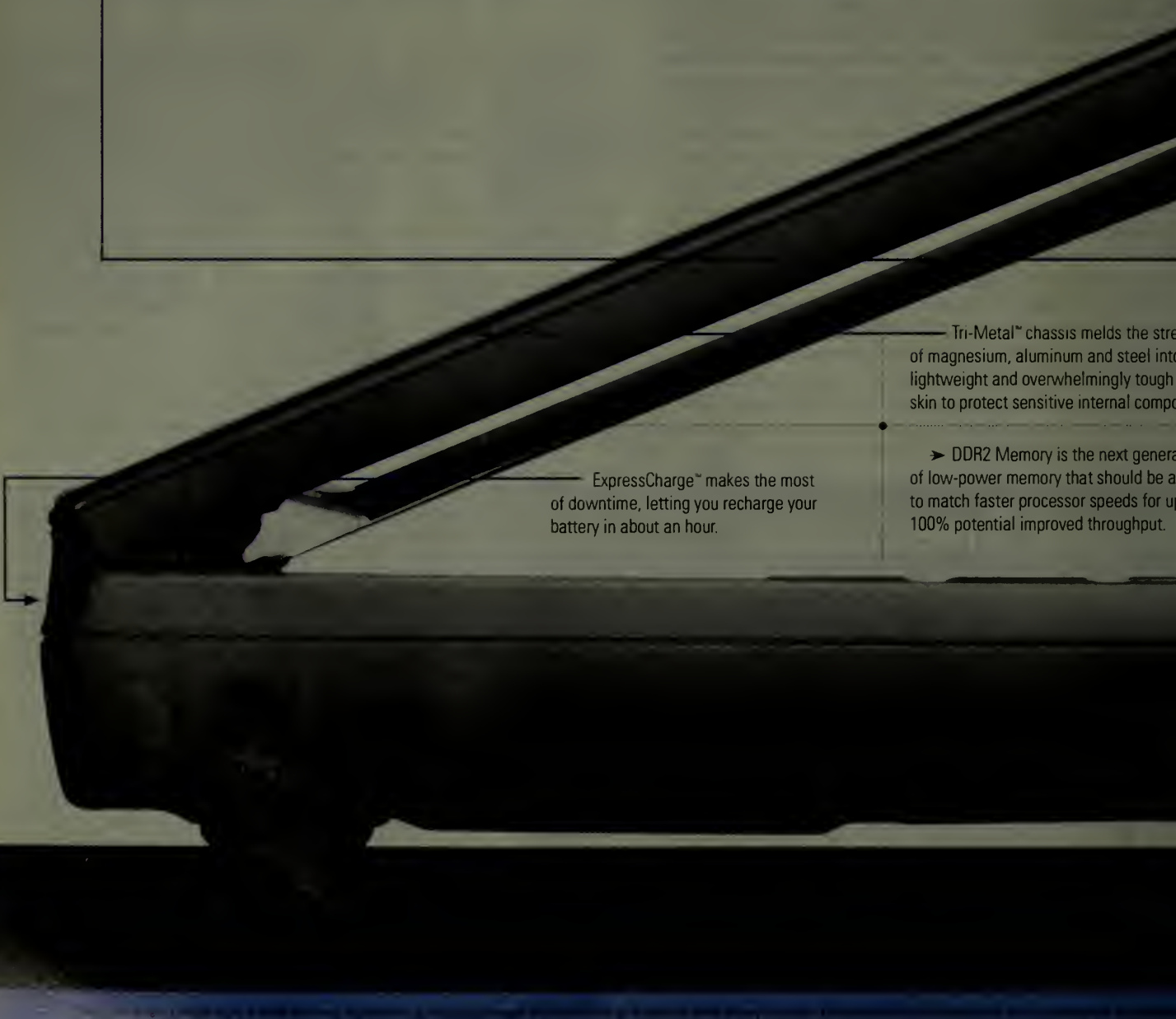
DOWNLOADS UNLEASHED Wireless operators are beginning to let customers buy music with their phones and then put it on other devices. Korea's SK Telecom is selling such downloads for 50¢ a song. O2 Germany plans a similar service later this year.

STREAMING MUSIC Sprint is alone among major carriers in the U.S. in offering 24/7 streaming music. For as little as \$5.95 a month, users choose among six channels of radio-like programmed music, from '80s hits to country tunes. Upstarts are working on technology to put satellite radio on mobile phones, too.

UNIVERSAL JUKEBOX In November, Korea's SK Telecom launched what could be the future of music on phones. It's offering a \$5-a-month service, called Melon, that allows unlimited downloads from a library of 700,000 tunes. Unlike subscription services in the U.S., Melon lets customers get a new song without a PC. That makes it a potential game changer: You can get any song you want anytime, anywhere—for \$60 a year.

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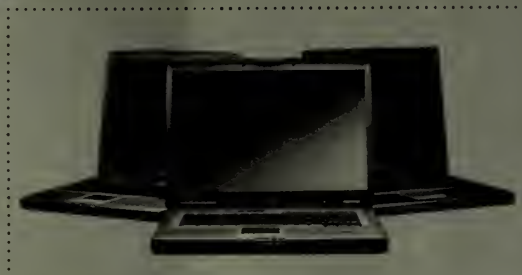
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possible at the edge of this frontier. Korea's SK Telecom Co. offers a \$5 a month music subscription that allows customers to download any of 700,000 songs to a phone, PC, or music player. That makes the subscription much more convenient than similar services in the U.S. because Korean customers can get any song they want, wherever and whenever they want it. Since the November launch, 300,000 people have signed up. "We are not yet making money, but we see a big potential for profits from music," says Shin Won Soo, a senior manager in charge of SK Telecom's music business, which is expected to go into the black with 800,000 subscribers. That conjures up the possibil-

ity that with music phones, consumers around the world could opt to pay a monthly fee for all the new music they desire rather than buying individual CDs when they debut.

U.S. wireless operators aren't going to cause an overnight sensation in music. Their first offerings are too expensive and clumsy to spark strong demand. Yet within a year or two, the operators have a real chance of giving the MP3 crowd a run for its money. The phone companies have a track record of refining their offerings until they attract the mass market. Verizon and its brethren have traditionally overpriced services such as broadband, long distance, and even cellular service and then lowered prices later. That's likely to be the pattern in music, too. "Anyone who doubts Verizon's capability, I would just say, 'Watch us,'" says Strigl.

The wireless companies are coming from far behind in setting up their music stores. Apple spent years refining its iTunes site and already has sold more than 300 million songs. Yet the wireless companies may have one advantage if they compete against iTunes on price. Because they already bill mobile customers each month, they wouldn't have to pay credit-card charges to Visa or MasterCard. That's not much of an edge over iTunes when customers buy a \$9.99 album. But if they buy single songs for 99¢ at iTunes, the fees total a significant 17¢ to 20¢. Bottom line: Verizon, Cingular, and Sprint could end up lowering their prices to \$1 a song and still make more profit than Apple does. "Business models will absolutely change," says Richard S. Siber, CEO of wireless consultant SiberConsulting.

Add it up, and Apple is facing what looks like the most serious threat so far to its digital music dominance. Of its trio of devices, the iPod may be the least affected. Its hard drive of as much as 60 gigabytes, or 15,000 songs, makes it a music aficionado's dream, and no phone can match it. The iPod mini and Shuffle are more vulnerable, since their storage is well within reach of a phone's capabilities. Some experts are convinced mobile phones will become the primary devices for carrying around tunes. "It's not a matter of if, it's a matter of when," says Scott Horn, a senior director at Microsoft Corp., which sells software for phones and music players.

Why are telecom players looking to steal some of Apple's thunder now? Technological advances in storage, compression, battery life, and wireless networks are making it easier to receive and store high-quality music on phones. Korea's Samsung Electronics just introduced a

phone with a 3-gigabyte hard drive, enough to store 1,000 songs. A 10-gig phone could hit the market within two years. And the future looks wide open. Research firm Strategy Analytics estimates that in 2008 half of the 860 million cell phones sold will be able to store and play songs, up from 8% today.

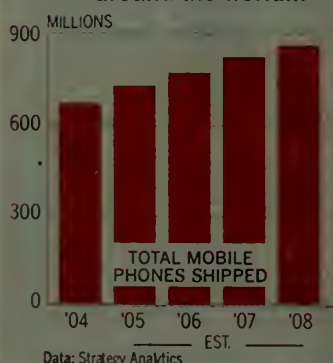
Wireless operators have seen what a gold mine music can be. Ringtones, the snippets of songs you can put on your phone to customize your ring, have become a huge hit. Operators charge customers \$1 to \$3 per download for a few bars of a song and keep most of that for themselves. Ringtone revenues have hit \$5.8 billion, and

A STARTUP IS PEDDLING A HILARY DUFF PHONE PACKED WITH HER MUSIC CLIPS

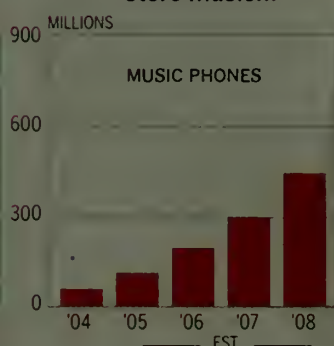


Hello Music

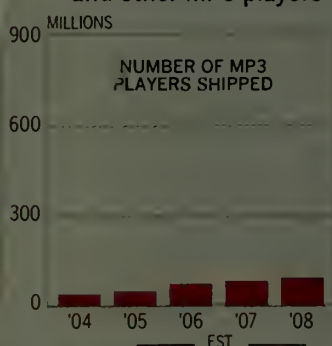
As mobile phones around the world...



...can play and store music...



...they'll outnumber iPods and other MP3 players



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that's expected to reach \$9.4 billion in 2008. "People are thirsty for music," says Combs. "It's a way to express themselves and their personality." The hip-hop mogul is currently exploring the launch of a wireless music services company targeted to youth.

The ringtone boom has made the record labels enthusiastic supporters of the wireless companies. "Carriers are a new kind of retailer with massive reach," says Eric Nicoli, chairman of EMI Group PLC, one of the four major music companies. "Plus, they have a competitive advantage over online services because their consumers can truly make impulse purchases on their phones."

The success of ringtones has given operators the confidence to push digital music even further. U.S. players are moving into downloads of complete songs, radio-like services with stations for hip-hop and indie rock, and much more. A startup called Single Touch Interactive Inc., based in Encinitas, Calif., is even peddling a Hilary Duff phone packed with the teen pop sensation's music clips and plastered with her image. "Downloading music to phones is the Next Big Thing," says Duff. "I think it's so cool."

Work is under way to make it even cooler. One major focus is a simpler way to move songs from one device to another. The initial downloading services have locked tunes onto the phone

More on iPod Killers, Only at BusinessWeek.com

Q&A with P. Diddy: Hip-hop impresario Sean Combs explains why wireless music will be a powerful force in the future.

Calling All Music Lovers: Is it a phone or a digital jukebox? Explore the new generation of stereo-quality, easy-to-use music phones in our interactive slide show.

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partly because, unlike Internet music services, early technology didn't provide a way to prevent multiple copies from being released to file-sharing networks. Now, Microsoft, digital media specialist Loudeye, and mobile music startup Melodeo are developing systems that provide better copy protection so tracks can be moved around easily and safely.

The first iterations are crude. Nokia, in partnership with Microsoft and Loudeye Corp., provides operators with technology to send customers two copies of a track. One goes to the phone and

Samsung Is Putting Songs in Its Heart

In recent years, the phone division of Samsung Electronics Co. has looked as if it might turn into a camera company. The unit—the world's No. 3 handset maker—now integrates cameras into nearly every new phone it makes, with some models sporting optical zoom lenses and resolution of up to seven megapixels. Today, though, the Korean company seems to have a new ambition driving its phone development: music.

Since last summer, Samsung has introduced more than 20 phones that double as MP3 players. Of course, most of these handsets still include cameras, but music is the hot trend. The new models range from devices that store a few dozen tunes all the way up to the SGH-i300, a phone with stereo speakers and a 3-gigabyte hard drive that can hold 1,000 songs. "Music will be driving demand this year, like imaging was last year," says Lee Kyung Ju, a Samsung vice-president.

The change dovetails with Samsung's drive to unseat Apple Computer Inc. as the world's No. 1 maker of music players by 2007. It's an audacious goal, given that Samsung sold just 1.7 million players last year, vs. Apple's 8.3 million iPods. But Samsung is serious about music. The



SEOUL Sold on MP3 player/phones

company plans to bring out a half-dozen new stand-alone music players by summer, with an eye toward selling 5 million players—or 10% of the global market—this year.

Samsung is even more ambitious with its handsets. This year, it expects to launch scores of new music player/phone combos with features such as surround sound, a

button for instant access to tunes, and a dial for playlist navigation. Samsung execs say that before long, most phones will double as portable jukeboxes with enough memory to hold hundreds of songs. And Samsung aims to stay at the forefront of the trend. "The mobile phone will be the center of digital convergence," says Samsung President Lee Ki Tae.

Korea's cell-phone carriers—and their subscribers—like the sound of that. Already more than 80% of phones sold in the country double as music players because Samsung's local rivals, LG Electronics Inc. and Pantech Co. have jumped on the music phone bandwagon, too. Korean mobile operators plan to sell more than 10 million such phones this year—about five times the number of music players Koreans are expected to buy. "I'm sure there will be far more people listening to music on their phones than on music players," says Shin Won Soo, senior manager at SK Telecom, Korea's largest mobile-phone company.

The enthusiasm of Korea's wireless carriers may give Samsung a leg up. The country's operators have led the way in experimenting with the wireless music business. And Koreans have proved eager to buy music from the country's operators, with 300,000 people now paying SK Telecom \$5 a month for a service, launched in November, that provides unlimited access to tunes. Now, Samsung says it has deals to supply music handsets to U.S. carriers Sprint, Cingular, and T-Mobile. In the battle between the cell phone and the iPod, Samsung may well be the chief arms dealer.

—By Moon Ihlwan in Seoul

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can't be moved, and the other, a copy-protected version, goes to the PC. By yearend, Nokia will do away with this clunky workaround so a customer can buy copy-protected downloads over the air and move them freely. Operator O2 Germany, a unit of Britain's O2 PLC, will use the Nokia solution in its wireless music offering, launching this summer, and Vodafone may adopt it. "Consumers are in charge here," says Vodafone's Ferguson. "They want the freedom to do what they want with songs."

Telecom operators also are working on new ways to market digital tunes. Inside Sprint, which looks like the most music-savvy operator so far, execs talk about the mobile phone as if it were a modern-day jukebox. The company is offering wireless customers Music Choice, the same 24/7 service offered by satellite and cable-TV operators. Sprint's service lets a subscriber

tune in to six different channels of music—rock, hip-hop, '70s, '80s, current hits, and country—for \$5.95 a month. Customers can't pick individual songs yet. But Sprint is working on imitating SK Telecom by providing users with hundreds of thousands of songs. It's even considering development of a mobile-phone cradle, attached to top-notch speakers, for home use.

Creative thinking inside cellular and music companies is leading to ways to tap into the social appeal of music, too. Right now, a kid sprawled on a college lawn can use his or her phone to let friends hear the latest Green Day song. With the next generation of wireless music technology, called superdistribution, that song could be zipped off to the phone of a friend, who could listen to it one or two times or buy it directly from a wireless carrier's service on the spot. "There are lots of exciting things you

Ringtones: Music to Music Moguls' Ears

Earlier this year, as the rapper 50 Cent was putting the finishing touches on his second album, *The Massacre*, for Interscope Records, the Jamaica (N.Y.) sensation carved out time from his studio schedule for an important task: recording a voice tone and a voice ringback. Those snippets would eventually let cell-phone users paying a one-time fee of \$2 to hear him when they received or placed a call. Then a musical ditty from the single, *Candy Shop*, was converted into a ringtone, making 50 Cent ubiquitous in wireless—just as *The Massacre* topped the charts in March.

For music executives still stung by Internet piracy and slammed for not moving quickly enough to exploit the Net, the industry is going to great lengths not to blow it with new wireless technologies. They're seeing that cell phones are just as important as CD and MP3 players, radio, and music videos. And ensuring that breakout artists like 50 Cent have content tailored for mobile phones is now a must, not just for the sake of promotion but as a critical new source of revenue.

Increasingly, selling \$13 CDs at retail stores is the old-fashioned way to make money on music. Now there's a host of fresh possibilities, from video game soundtracks to preloaded artist catalogs on hard drives in cars—imagine an Elvis Cadillac or a Britney BMW. Meanwhile, lawyers are working overtime on new publishing, royalty, and licensing agreements for the nascent business models. Cell phones now represent

enough promise for all the major music companies to be setting up mobile-business divisions. "With 180 million handsets in the U.S., how could we not be bullish on the mobile market, especially now that downloads to phones are possible?" says Thomas Hesse, president of global digital business at Sony BMG Music Entertainment.

But no matter how many new businesses emerge, music execs still face an uphill battle competing with free. After the first uptick in music sales in years in 2004, the figures dropped again—by 6%—in the first quarter of 2005, to 134.8 million albums, according to Nielsen SoundScan. About 750 million songs are still being swapped unauthorized or free on the Internet every month, according to file-sharing tracker Big Champagne. To understand the magnitude of the threat, consider that the most successful legal download service, Apple Computer Inc.'s iTunes Music Store, has sold less than half of the illegal monthly volume, 300 million songs, since its launch two years ago.

Spinning Faster

What's more, digital-music sales are still a tiny sliver of the overall pie. Digital music, mostly made up of downloads on the Internet and tones on cell phones, accounts for roughly 2% of the \$30 billion global music business. But executives see a quick ramp-up. Alain Levy, CEO of EMI Music, for one, has said that digital sales could be 25%

of his company's total in five years, with cell-phone downloads and subscriptions making up a big chunk. In the first six months of its fiscal year ending last November, EMI reported digital sales that doubled year-on-year, to \$37.8 million, still just a fraction of its \$1.6 billion in total revenues. Much of the digital gain was attributable to online sales in America, mobile revenues in Japan, and ringtone revenues at EMI Publishing.

Ringtones are driving most of the mobile-music business today. The replication of songs into a series of tones costs customers \$1 to \$3 apiece. As their sound quality improves, so will demand, say executives. If there was any doubt of their importance to the future of music, the industry's stalwart trade magazine, *Billboard*, now compiles a regular chart of the 20 Hot Ringtones. Thanks to teenagers who sometimes swap out ringtones as many as three to four times a week, they will become a nearly \$9.4 billion business in 2008, estimates consultant Strategy Analytics Inc. "Ringtones are all about personalization. They are self-expression," says Rio Caraeff, vice-president of Universal Mobile Music. "You buy a ringtone for a different reason than you buy a download of a song." How about Joss Stone's *You Had Me* as the ring for an ex-husband, or Sinatra's *New York, New York* for a cousin in Manhattan? Assigning a tune to a caller is an expressive way to make a statement about a person or a relationship.

The fact that the industry is embracing all kinds of new formats for selling music might be the one good thing to come from the nightmare of the past several years, says Mark Harrington, a media analyst at Bear, Stearns & Co. in London. "The music industry is where the movie business was 20 years ago—trying to figure new revenue streams. For Hollywood, it was establishing [staggered] releases to VHS, then DVD, to premium cable, to now [video on demand]."

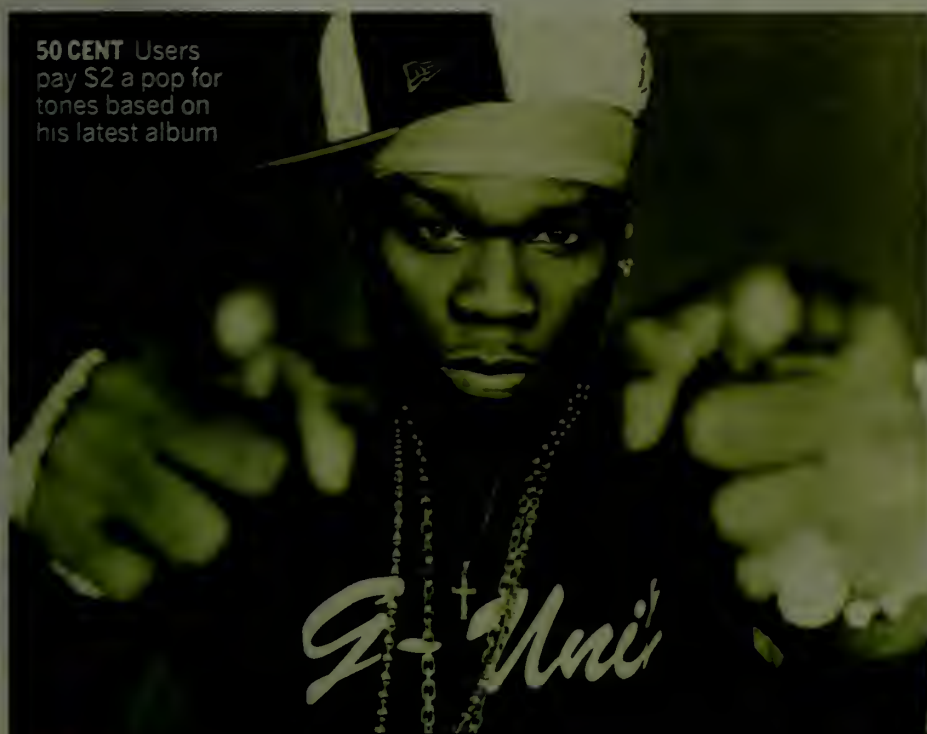
can do that bring in the social dimension,” says Hal R. Varian, a professor at the Haas School of Business at the University of California at Berkeley. “Labels need a platform where they can experiment more, and they can do that with wireless.”

Phone makers, meantime, are focusing on making their products more music-friendly. Mobile music skeptics argue that only tech geeks will be patient enough to navigate a music playlist on the cumbersome keypads and tiny screens of most phones. “As long as the primary point of a cellphone is to be a good phone, any entertainment component will be somewhat lacking,” says Jonathan Sasse, president of iRiver, a leading maker of MP3 players. But manufacturers from Motorola to Hong Kong contract manufacturer HTC are hustling to make phones easy to use. HTC’s SDA has little buttons built in to the phone that let the

user play, pause, fast-forward, and rewind songs. Sony Ericsson Mobile Communications’ new Walkman phone and Motorola’s new E680i sport built-in FM radio receivers and cables that make it a snap to transfer music from a PC to a phone.

Who would have thought the cell phone would evolve from a brick-sized talking device to a pocket-sized jukebox? In early April, 1973, to much fanfare, a Motorola researcher made the first reported call using a handheld wireless phone. Now, Jason Smikle and his buddies not only can talk on one, they can dance to stereo-quality tunes booming from the little gadgets. Music on phones is coming of age. Watch out, Apple. ■

—With Heather Green and Tom Lowry in New York, Moon Ihlwan in Seoul, Andy Reinhardt in Paris, and Peter Burrows in San Mateo, Calif.



50 CENT Users pay \$2 a pop for tones based on his latest album

PENNIES FROM HEAVEN

The music industry got burned by the Internet but is now getting a lift from cell phones. Down the road, there's a rosy future in wireless downloads of entire songs. But now, the big bucks are in ringtones.

TOTAL RETAIL REVENUES, IN BILLIONS	2004	2008*
MONOPHONIC RINGTONES These are the most prevalent now, but higher-quality tones will be available soon. They play one note at a time and sound like a series of beeps. Music publishers take about 10% of price.	\$0.671	\$0.042
POLYPHONIC RINGTONES They combine up to 16 notes, providing for a richer sound. Music publishers take about 10% of price.	4.1	2.6
TRUE TONES The master recording of a song. Music companies can take up to 30% ; publishers get a 10% cut, as well.	0.565	4.5
RINGBACK TONES Instead of the ring-ring, caller can hear a song of choice when dialing a certain person. The music-industry take depends on terms of the subscription plans offered by cell-phone operators.	0.436	2.3
TOTALS	\$5.8	\$9.4

*Estimates

Data: Strategy Analytics BusinessWeek

Up until then, film libraries had little value, he says, but now they are being thoroughly mined in a booming DVD market. The message for music and its catalogs is parallel: The new technologies are making it possible to wring even more profit from the industry's vast song libraries. Music execs should no longer care about where revenues come from, says Harrington, especially since operating margins for digital music sales are expected to be 18%, vs. about 12% for CDs. What has music moguls even more upbeat on cell phones is the relative security they offer compared with the Internet, they say. “Cell phones are a closed system,” says Sony BMG’s Hesse. “And a payment system through credit-card billing is built into the device.”

Nobody understands the prospects for digital music better than the publishing side of the business, which collects money for the rights of songwriters from radio plays, live performances, TV commercials, and movies—and now ringtones. Publishing has always been a high-margin part of the business, but it stands to make a killing in this new world because of all the new ways for music to reach fans. “We love additive products, believe me,” says Martin Bandier, CEO of EMI Music Publishing, the world’s largest music publisher, with a catalog of more than 1 million songs. “It’s like we are in the bread-crumbs business. Sooner or later, you get a loaf of bread.” Bandier says his company collects about 10% of the retail price of ringtones. The songwriter gets paid a royalty from that.

Despite the payoffs, threats still loom. There’s new software, Xingtones, costing \$20, that converts MP3 files to ringtone formats, pushing once again into the realm of free. Even so, the trick for the music industry will be to learn from the past—that new technologies mean new opportunities. Just ask 50 Cent.

—By Tom Lowry in New York



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SUPPLY CHAIN

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EXCELLENCE

After you've fiddled with labor costs, R&D, procurement, and such, if you're looking for ways to boost financial performance (and who isn't?), there's still one slice of uncharted corporate terrain where additional business value is there for the taking. Pick your head up a bit and you just may notice it: the supply chain.

According to a recent report from Boston-based AMR Research Inc., companies that excel in supply-chain operations perform better in almost every financial measure of success. Where supply-chain excellence improves demand-forecast accuracy, companies have a 5% higher profit margin, 15% less inventory, up to 17% stronger "perfect order" ratings, and 35% shorter cash-to-cash cycle times than their peers. Companies with higher perfect-order performance have higher earnings per share, a better return on assets, and higher profit margins — roughly 1% higher for every three percentage-point improvement in perfect orders.

"The basis of competition for winning companies in today's economy is supply-chain superiority," says Kevin O'Marah, vice president of research at AMR Research. "These companies understand that value-chain performance translates to productivity and market-share leadership. They also understand that supply-chain leadership means more than just low costs and efficiency — it requires a superior ability to shape and respond to shifts in demand with innovative products and services."

AMR Research

INCLUDES AMR RESEARCH
SUPPLY CHAIN TOP 25

SUPPLY CHAIN EXCELLENCE

In fact, AMR Research recently named its top 25 supply-chain performers — manufacturers that have embraced demand-driven supply-chain practices and technologies and are winning as a result. Led by Dell, Nokia, and Procter & Gamble (chart), the companies share a distinct approach. "Leading companies view their supply chain as a strategic competitive asset to be maximized and not as a fixed-cost liability on the balance sheet," says Michael Maguire, vice president of supply-chain business development at SAP America, in Newtown Square, Pa. "When you talk to supply-chain leaders at a company, you very quickly know on which side of the ledger they view supply-chain operations."

Other vendors agree that approaching the supply chain as part of the company's core competency is a key marker of supply-chain excellence. "Companies sharing this view understand that, with proper management, they can take massive amounts of cost out, or be able to have the right merchandise on the shelf for the customer to buy," explains Joe Cowan, CEO of software vendor Manugistics Group Inc., in Rockville, Md. "Supply-chain leaders understand the strategic importance of their supply chain and work very hard to ensure that they properly manage and control it."

CASH IN HAND

Moreover, experts say, supply-chain leaders are driven by customer demand. "They base the entire system on meeting the customer need or solving the customer problem," says O'Marah. "They do not focus on using the Internet or technology tools to improve plant operations or any of the other hard assets they own. They use the tools to have a higher perfect-order rate or reduce total materials-handling cost and still meet customer orders. For them, the customer really is king."

In the 1980s and for a decade thereafter, that saying meant mostly that companies sold in the way the customer wanted. But today's supply-chain leaders routinely change their operations — in ways such as how they replenish a shelf, pack a box, load a truck, or dispatch a fleet — to meet customer needs. It's all about what Procter & Gamble's supply-chain experts call "the moment of truth" — the time when the customer chooses the vendor's product from the shelf. If the supply chain does not ensure that the product is actually on the shelf when the customer makes his or her choice, the moment of truth ends without a purchase.

Supply-chain leaders consistently make choices that support customer satisfaction — and, more importantly, customer payment. "People always forget about this," says O'Marah. "They talk about delighting the customer and exceeding their expectations. All that stuff is fine, but it's completely useless if you lose money with

every transaction." Supply-chain leaders make what customers want to buy, rather than merely trying to sell what the company makes, and ensure that customers are satisfied and pay for their purchases.

GETTING YOUR SHARE

Such dedicated focus on supply-chain operations can generate dramatic business benefits. A recent AMR Research report compared the supply-chain processes of companies judged to be the best, median, and worst performers. The research calculated the amount of cost that could be removed from supply-chain operations when companies use supply-chain tools to improve from worst to best practices.

The verdict: supply-chain leaders are prime candidates to share in what O'Marah estimates as \$488 billion in untapped annual operating margin. Interestingly, this sum is approximately the same amount that was believed to be lost after the dot-com bubble burst in 2000 and 2001. "People expected the Internet to change the world, but most bet on the concept that it would dramatically affect supply-chain operations through B-to-C and B-to-B sales," O'Marah says. Instead, the Internet's primary value to supply-chain operations is as a communications platform that supports collaborative design, planning, execution, and replenishment. "Today we know who knows how to use these tools to their advantage," he says. "The \$488 billion in potential operating profit will be earned by the companies who use these tools, not the ones who sell them. All of that value is still there, and it will accrue to the companies that take advantage of this way of doing business."

FAST REFLEXES

How can those companies who are not considered supply-chain leaders share in this bounty? The first step is to adopt some of the approaches, foundational beliefs, and technology used by the leaders.

"We see a growing separation between best-practice companies and those that are average," says Michael Schmitt, executive vice president and chief marketing officer for Ariba Inc., in Sunnyvale, Calif. "Those companies that understand the value of spend management are leaps and bounds ahead of the others in accelerating savings to the bottom line."

For example, best-in-class companies surveyed by Ariba capture four times the information about their overall spending than the average company. They are 78% more likely to use sophisticated technology and sourcing tools, and they invest 189% more than the laggards in technology that enhances decision support. Using these tools gives supply-chain leaders better information about spending patterns, which they can use to sense and respond to opportunities on both the demand and supply sides.

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"Changes in opportunity may present themselves at any time," says Schmitt. "A company that takes weeks or months to react is at a substantial disadvantage to the companies that can react in days or hours. At the end of the day, supply-chain excellence is all about companies making decisions faster than their competitors."

Yet typical supply-chain tools can present companies with an ocean of information about customer demand, supplier capabilities, and internal capacity. "These data can hit you like a blast from a fire hose," he adds. "The challenge is to use tools that help you make sense of that information at a granular level, define what's important, model it, and optimize it to make decisions faster than your competition. It's that ability to sense and respond that's separating the best-in-class spend-management leaders from the laggards."

GO WITH THE FLOW

Moreover, because leading companies understand the strategic importance of their supply chain, they elevate

decision making to senior executives. "The success that some companies are clearly achieving and the pressures from some customers such as Wal-Mart are forcing other manufacturers to seriously rethink their supply-chain operations," says Cowan of Manugistics. "These companies choose tools based on how well they can improve the supply chain. The decision is based on what makes sense for the benefit of the entire enterprise, rather than the benefits to just one particular organization, such as procurement or IT."

Recognizing the bottom-line value that supply-chain excellence can deliver, some experts even advise that companies elevate it to a board-level issue. "To make the transition to supply-chain leadership, companies must return to the basic questions of how they measure their supply-chain operations," says Maguire of SAP. "If they focus primarily on efficiency and cost minimization, they will be solving yesterday's problems with yesterday's solutions."

Instead, he says, companies should begin to measure

AMR RESEARCH SUPPLY-CHAIN TOP 25

- 1 Dell** The defining demand-driven supply network (DDSN) business. Growing 17% in the PC business on a \$40B revenue base is phenomenal.
- 2 Nokia** Historically a great innovator; supply-chain best practices turn ideas into profitable businesses.
- 3 Procter & Gamble** P&G's consumer-driven supply chain is the defining architecture for large consumer companies. Best practices in product innovation and supply-chain effectiveness are tops.
- 4 IBM** IBM is growing the equivalent of a \$10B business every year and has overhauled its hardware supply-chain and product-development processes to the tune of 70% better, faster, and cheaper.
- 5 Wal-Mart Stores** Everyday low prices defines the customer demand driving this and, increasingly, everyone's supply chain.
- 6 Toyota Motor** Lean is one of the top three best practices associated with benchmarked supply-chain excellence. Toyota literally wrote the book.
- 7 Johnson & Johnson** Johnson & Johnson shows consumer and life sciences leadership delivered with embedded innovation into multiple channels.
- 8 Johnson Controls** Little known, but much admired, JCI has pioneered such principles as product platform strategies in the hypercomplex engineering challenge of the auto industry, all the while making money and growing.
- 9 Tesco** The UK-based grocer was the first to really succeed with direct-to-consumer sales while maintaining killer inventory turns and growth.
- 10 PepsiCo** Pepsi's consumer-centric businesses "sense and respond to" the pulse of demand with product innovation and lean supply chains; youth markets seem aware as the Mountain Dew crowd grows.
- 11 Nissan Motor** Lean and stylish, Nissan combines much of Toyota's execution with its own highly successful design.
- 12 Woolworths** The supply-chain operations of this Australian retailer are regarded as pioneering in the use of 21st-century supply-chain principles.
- 13 Hewlett-Packard** The IT mega-provider combines some units in transition (server division) with others that are world-class (printer division) and has merged the CIO and global supply-chain function in a single individual.
- 14 3M** Diversified is putting it mildly for this industrial and consumer products leader. Its extraordinary combination of the practical and the cutting edge has units like Industrial Services operating in a DDSN mode.
- 15 GlaxoSmithKline** Maybe the strongest big-name pharma player to emerge from the industry's current troubles, GSK innovates not only in the area of discovery but in the industrialization and commercialization of new drugs.
- 16 POSCO** The Korean steel giant has begun to garner attention for its extraordinary success in managing a hugely capital-intensive business.
- 17 Coca-Cola** Like archrival Pepsi, Coke knows how to quickly cycle consumer needs, tastes, and trends back to the market with winning products; witness the Dasani bottled-water success story.
- 18 Best Buy** The ultimate short-lifecycle retailer, Best Buy sells cutting-edge electronics to the gadget enthusiast. By realizing the DDSN principle, the retailer has radically thinned inventories and delivered enviable in-stock positions.
- 19 Intel** By working across the electronics value chain Intel has managed what few could, to be massively asset-intensive and yet nimble in the market.
- 20 Anheuser-Busch** Born-on dating is no marketing ploy. It is a supply-chain challenge that other brewers can't easily meet. No one has taken real-time demand responsiveness further than AB.
- 21 The Home Depot** A pioneering category killer, The Home Depot is cutting-edge in logistics and innovative services.
- 22 Lowe's** Lowe's faster growth challenges nemesis The Home Depot via a consumer-friendly shopping experience.
- 23 L'Oréal** By telling consumers they're "worth it," L'Oréal has shaped demand and delivered.
- 24 Canon** The world's largest maker of copiers has engineered a new supply chain and rapid growth.
- 25 Marks & Spencer** A pioneer in the use of RFID in stores, M&S manages to grow and stay lean.



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their supply-chain visibility, responsiveness, and adaptiveness. When these measurements are connected to the overall top-line measurements at the CEO level — such as the growth of market share, revenue, and product mix — the supply chain will start being viewed at the boardroom level as a strategic asset instead of a shared cost liability.

In addition, leaders try to synchronize their supply chain with that of their suppliers, communicating anticipated needs so that suppliers know what will be expected of them. "There is an understanding here that the supply chain is not static, that you can't solve the supply-chain problem once and be done," says Cowan. "Good companies continue to adapt as conditions change. But that requires working with a solution provider that can help you solve problems, apply new thinking, and find a strategic way to approach the solutions. A software-only solution can be a disaster. You need a partner who will help you adapt to changing conditions."

JUST-IN-TIME WORKFORCE

Supply-chain leaders are also willing to expand their control of the supply chain to areas previously considered out of bounds. For example, the workforce is a critical asset for many manufacturers and other companies that provide goods or services. Recognizing the importance of this asset, some organizations are beginning to apply supply-chain concepts to managing their workforce.

"Workforce management is as strategic as other critical infrastructure investments that companies have made in terms of achieving boardroom objectives such as earnings per share, profitability, and revenue," says Michael DiPietro, vice president of product marketing and strategic alliances for Kronos Inc., a workforce-management software vendor in Chelmsford, Mass. New technology allows companies to focus on demand signals — such as customer behavior, the economy, market trends, and changing corporate strategy — so they can more effectively staff their operations and schedule workers.

"It's a fundamental question of how changes to your work, assets, and supplies affect your workforce," says DiPietro. "When front-line managers can understand demand better, their workforce decisions become more demand-driven, translating demand into workload requirements and building the 'perfect' workforce to accommodate those."

One large health-care company, Phoenix-based Banner Health, is using workforce management to link demand with staffing and scheduling. The company, which employs 27,000 workers in 19 hospitals, six long-term care centers, and other facilities in eight midwestern states, estimates that 40% to 50% of its operational costs are spent on labor.

Banner implemented Kronos workforce management software to more accurately capture time and attendance



Supplier Diversity Doing Well by Doing Good

Not all aspects of supply-chain excellence are a function of technology and tools. For Cargill, the international provider of food, agricultural, and risk-management products and services, supplier diversity is a critical component of its performance-centric supply-chain operations.

Cargill makes a point of including suppliers from many backgrounds — including small businesses and businesses owned, controlled, and operated by minorities and women. As a result, the company is making continuing progress to satisfy its diverse customer base, enrich communities, and enhance profitable growth.

Supplier diversity is critical to meeting government small-business and diversity goals — but it happens also to be a winning strategy for achieving supply-chain excellence. "We find that diverse companies, even though they typically are smaller, are more attentive to our needs," says Tim Thomas, director of supplier diversity for Minneapolis-based Cargill. "They are often more amenable to assisting us with R&D projects and on-time delivery solutions, and they address procurement niche areas that larger corporations aren't always willing or able to fulfill."

Better supplier service means better support for Cargill's customers. "Supplier diversity becomes a distinctive value and a competitive advantage for us," he adds. "We think it's a win/win situation for everyone — Cargill, our diverse suppliers, our customers, and the communities that we and our customers live and work in — by providing jobs that bring money back into the community. There is no reason why companies shouldn't embrace supplier diversity. It's just a matter of doing good business!"

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data and pay employees. Now patient demand is factored into scheduling and staffing. Banner employees have input to their work schedules, payroll checks are received sooner, and payment errors have been reduced. These changes have contributed to improved employee satisfaction and retention — critical in a marketplace where nursing skills are in short supply — and enabled Banner to reduce labor costs as well. "Our workforce is extremely happy with the new system, and our management is, too," says Kathy Schultz, a Banner IT executive.

PINPOINT ACCURACY

In certain industries, such as electronics components, rapidly fluctuating demand creates the twin problems of excess inventory and inventory shortages. To help even out inventories for manufacturers, distributors and brokers buy and sell between 5% and 15% of all products — a marketplace worth from \$15 billion to \$50 billion.

New technologies and services are helping some manufacturers optimize their inventory shortages and excesses. "It's a very inefficient process today," says Stu Clifton, CEO of service provider New Momentum Inc., in San Clemente, Calif. "Using our combination of software, hosted services, and a network-security appliance, companies can address their inventory liability problems and implement best practices that will mitigate these problems."

One industry consultant recently used the New Momentum subscription service to find a missing part for a client. "A large consumer-electronics manufacturing company was about to go 'down line' on production, which could have cost millions of dollars," says Brian O'Neil, general manager of consultant IC Trends in Sunrise, Fla. "By using New Momentum's MarketMaker1000, we were able to reference the data and locate the parts from a local vendor within minutes. The manufacturer's line stayed up and running, and we gained not only profit from this deal, but a loyal and happy customer."

THINK BIG, START SMALL

So how should "average" companies begin to pursue supply-chain excellence and the attendant bottom-line rewards? Think big, but don't go too broad. "You should start small — across a certain customer set or supplier set, for example — but be wide in terms of enhancing the complete cross-enterprise supply-chain process, from a secondary supplier to an OEM to a distributor, all the way to the end customer, for example," says Maguire of SAP. "Make sure that you get a tangible, measurable win within 120 to 160 days. You need to have a longer-term supply-chain improvement plan as a roadmap, but from what I've seen, every supply-chain improvement team

needs to justify its existence with quantifiable success every two quarters to stay intact."

O'Marah from AMR Research recommends starting with the sales and operations planning process "because it is simple, requiring only that you convene and attend a meeting. And it's a perfect place to learn how the technology can help you. If you want to learn how to use a forecasting tool or digest sales data or simulate market acceptance of a promotion, that's the meeting where you should play with the tools."

Another recommendation is that companies begin embedding product innovation into supply-chain operations. Says O'Marah: "Innovation can't be an externality. If all of your R&D, product development, and market-planning activities exist as isolated activities, you will miss this boat for sure."

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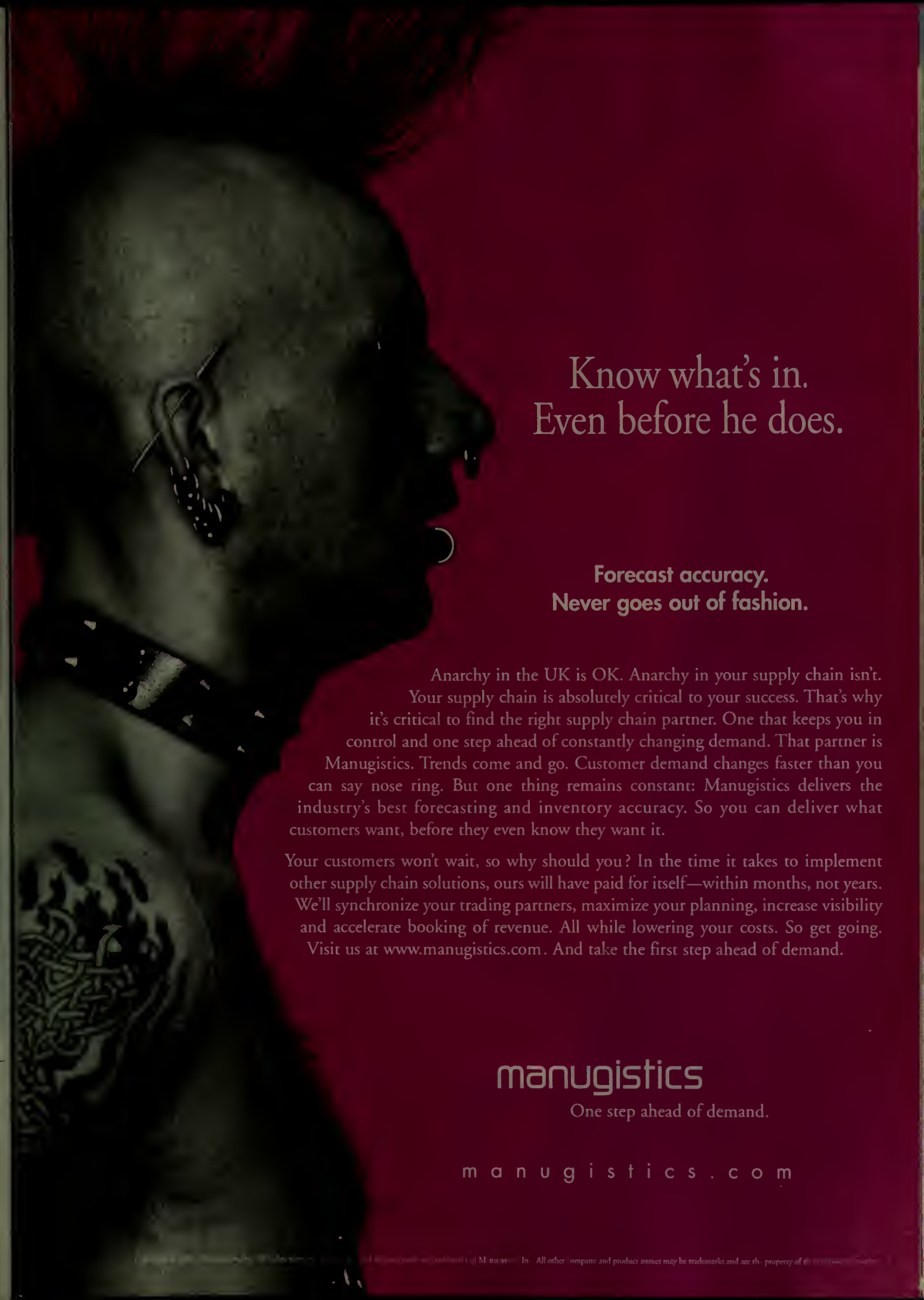
Produced by The Custom Publishing Group, www.custpub.com

Written by Cheryl Krivda, cherylkrivda@custpub.com

Designed by Segal Savad, www.segalsavad.com

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INNOVATIONS

Tiny drones and smokers' grandkids

►►A remote-controlled spy plane the size of this magazine may one day help troops figure out what's on the other side of a hill. The Defense Advanced Research Projects Agency (DARPA) flight-tested the 6-ounce, 13-inch wide Wasp, designed by AeroVironment of Monrovia, Calif., during naval exercises in March. It is launched by a flick of the wrist, carries two video cameras, and is powered by lithium-ion batteries that can keep it going for almost two hours. The Wasp is tough to see from the ground, making it ideal for quick reconnaissance missions.



►►A child whose grandmother smoked is twice as likely to develop asthma as the child of a nonsmoking grandmother, even if the mother didn't smoke, according to researchers at the University of Southern California. The scientists, reporting in the April issue of *Chest*, based their findings on interviews with the parents or guardians of 908 children. They speculate that when a pregnant woman smokes, the tobacco may alter the DNA of the fetus. That damage may increase the child's susceptibility to asthma, which is in turn passed down to her children.

BIOLOGY TRULY, LORD OF THE FLIES

MIND CONTROL IS

getting less theoretical—at least for flies. Researchers at Yale University have created genetically engineered fruit flies that jump, beat their wings, and fly on command in response to laser pulses.

This is more than a parlor trick. Gero Miesenbock, associate professor of cell biology, and graduate student Susana Lima reported in the Apr. 8 issue of *Cell* that similar techniques might one day be used to restore neural signals lost through disease or injuries to the spinal cord.

The researchers started by identifying a small subset of neurons in a section of the fly's brain called the giant fiber system, which controls movements such as jumping and flight initiation. They



then genetically encoded these cells to be activated by certain ion channels, proteins in the brain that allow charged particles to pass through a cell membrane. The channels are sensitive to ultraviolet laser light. Sure enough, when altered flies were zapped with millisecond pulses of the laser, they began escape movements such as extending their legs and rapidly flapping their wings.

MINING A BUG'S LIFE: WORKING UNDERGROUND

MINING COMPANIES have experimented for years with mineral-eating microbes that can separate gold and other metals from their natural ores. However, the bugs continue to break down the ore and release metals into waste water after a mine is closed. These metals may be toxic—or useful, if they could be retrieved, say scientists at the University of Wales at Bangor, who have developed another bacterial process to salvage the runoff.

The process is called metal biorecovery. Usually, rock-eating bacteria help render sulfide minerals water-soluble, allowing miners to separate them from the desired metal. In the new system, different microbes turn those sulfides back into insoluble metals so they can be recaptured, says lead researcher Barrie Johnson.

—Jordan Burke



CHEMISTRY WHOSE MOLECULES ARE THESE?

THE NATIONAL INSTITUTES of Health thought it had a great idea for advancing science—but its concept is threatening the world's largest scientific society. The plan: Put information about a vast number of molecules, which could be used to probe genes and biological functions, into a public database, dubbed PubChem. Scientists then could use the data to uncover new knowledge or new drugs. The information would come from other public databases, scientific papers, and publicly funded research.

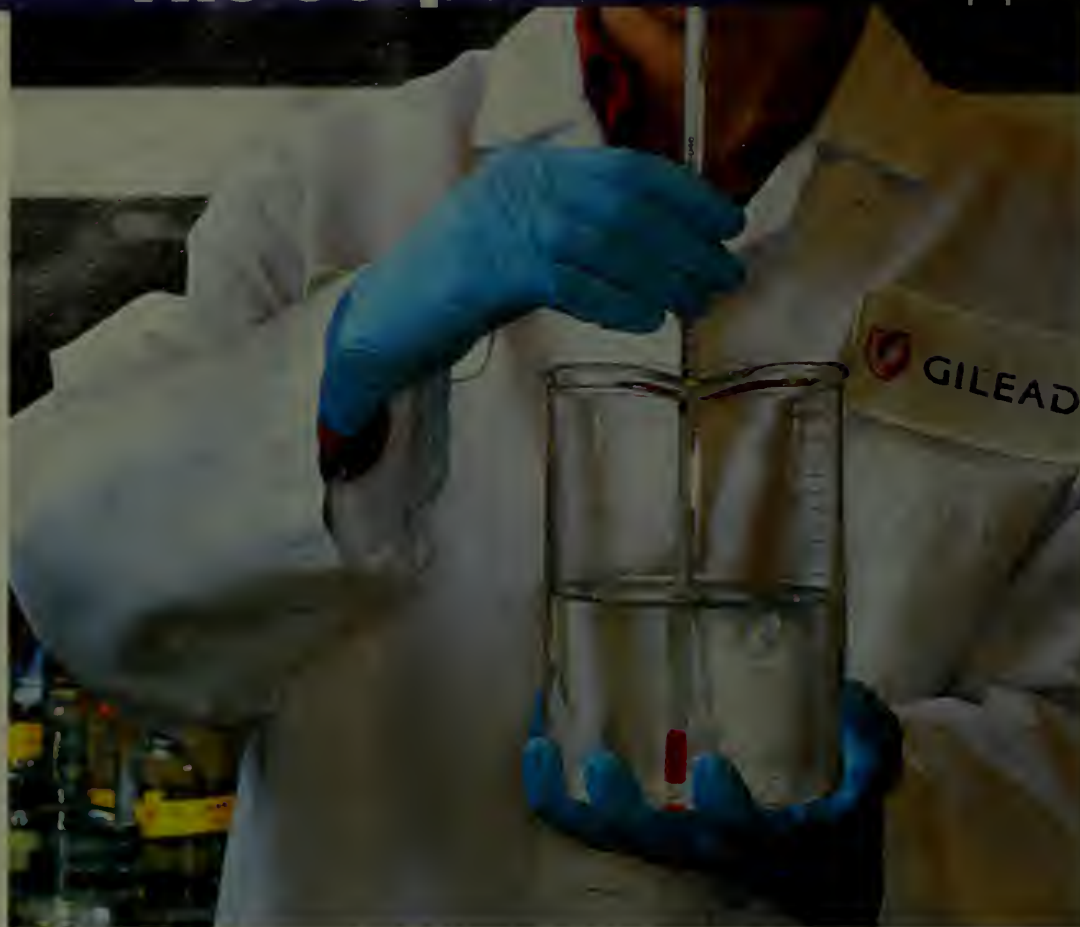
But the project has run into fierce opposition from the 158,000-member American Chemical Society (ACS). The nonprofit group has its own database of 22 million molecules, the Chemical Abstracts Service, that typically costs thousands of dollars to access and accounts for more than half of the society's \$421 million annual budget.

The two databases are complementary, argues NIH's Dr. Francis Collins: "We have no intention of duplicating information." But ACS complains that PubChem, which already contains data on 850,000 molecules, looks virtually identical to its offering. "Do taxpayers want their money to be used for something that's already done well in the private sector?" asks

ACS Executive Director Madeleine Jacobs.

The warring factions have agreed to try to work out a solution. "I hope we can resolve this in a way that does not put us out of business," says Jacobs.

—John Carey



A Small Biotech's Big Growth Spurt

Gilead rivals the majors in HIV drugs. Now it must expand beyond its niche

IT WAS 1999, AND JOHN C. MARTIN finally had something to show for his decade of leadership at fledgling Gilead Sciences Inc.: Preveon, a promising new drug to combat human immunodeficiency virus (HIV). But late in clinical trials, patients started dying from kidney failure, and the drug had to be scrapped. That was doubly worrying because Gilead's next drug in the pipeline, Viread, was a close cousin to Preveon. With little revenue and big expenses, Martin quickly had to decide whether to pull the plug on Viread. So the former researcher spent months delving into the science to figure out what went wrong. He decided to stick with Viread—and even predicted that it would be 10 times safer.

Martin was right. Just six years later, Viread is Gilead's top-selling drug, with \$780 million in revenues. Even Preveon was salvaged, renamed Hepsera, and sold at a lower dosage to treat hepatitis B. It contributed \$112 million to Gilead's top line last year. "He turned a defeat into two wins," says Gilead Chief Financial Officer John F. Milligan.

Martin's low-key yet intense focus has helped make Gilead a rarity: a profitable biotech that can compete with Big Pharma, albeit in a narrow market. It has increased revenues at a 79% average annual clip over the past three years, crossing the \$1 billion in sales mark last year, and

THE RIGHT MIX Gilead is racking up FDA approvals on the strength of its trial data

now boasts the third-largest market value among biotechs, at \$17 billion. A slew of recent Food & Drug Administration approvals of its HIV drugs propelled the Foster City (Calif.) company to No. 47 on this year's BusinessWeek 50 list of top corporate performers.

Now, though, Gilead's challenge is to demonstrate that it's equipped to market those new drugs—and develop other smash hits beyond its stable of HIV combatants. Investors remain unconvinced. That's why Gilead's stock trades at a considerable discount to its peers—its price-earnings ratio of 39 is minuscule in biotech (chart, page 85).

ATLANTIC CROSSING

GILEAD FINDS itself at something of a cultural crossroads as well. The scientist-execs at its

helm have preferred to let their industry-leading HIV drugs speak for themselves, in contrast to the pushy pitches doctors get from Big Pharma. But last fall, Gilead poached Kevin Young from biotech giant Amgen Inc. to head sales and marketing. Young brings polish and big-league experience to Gilead's professorial lab types.

The gregarious British native is recruiting new salespeople and hitting the European market hard, with two sales launches there already this year. "We went through this amazing growth spurt, and I think the commercial side is just catching up," Young says, describing Gilead as a gangly teenager. Viread, which makes up 60% of the company's \$1.3 billion in revenues, is the linchpin in Gilead's plan to boost its \$880 million HIV franchise to \$2 billion in coming years, analysts say. Gilead's net income hit \$449 million in 2004.

Gangliness aside, Gilead has become a drug-producing force. In less than two years, Viread, Hepsera, and a second HIV drug, Emtriva, have all been approved. That was followed by last year's approval of Truvada, a combination of Viread and Emtriva. It's a testament to Gilead's approach—pitching only those drugs that have rock-solid trial data behind them. In that same time only 30 drugs were



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approved industrywide, Martin says.

The downside to these successes? Gilead's pipeline has been sucked dry. As a result, even as it ramps up sales efforts, the company could use another hit drug. Gilead hopes a combination of Truvada and a third drug by partner Bristol-Myers Squibb Co. will go to market in 2006. The unnamed triple would be the first time HIV patients could take three necessary treatments for the disease in one pill, once a day—huge progress from the days when patients took 20 pills. Says Dr. Lisa Stermann, a San Francisco physician: "It's going to revolutionize everything."

EYEING ONCOLOGY

REFILLING THE PIPELINE for the long term will be more challenging. Gilead has signed three partnerships in the past six months to help develop new drugs: two for hepatitis C and yet another for HIV. It will foot much of the cost—at least \$300 million—for clinical trials in exchange for the rights to market the drugs in most of the world. But analysts want something juicier, such as a move into the competitive but lucrative field of cancer research.

That's a hotly contested topic in the sparsely decorated halls of Gilead's head-

A BIOTECH DISCOUNT

Gilead has four recent drug approvals and a sparkling balance sheet, but it still trades at a discount to peers:

	PRICE-EARNINGS RATIO (TRAILING 12 MONTHS)
GILEAD SCIENCES	39
GENENTECH	62
BLOOMBERG US BIOTECH INDEX	85

Data: Bloomberg Financial Markets

quarters. At issue is whether the company might lose part of what made it a major player in HIV: a tight focus on doing one thing and doing it well. "We've got the cash and the [ability] now, but we spend a lot of time debating the merits of it," says CFO Milligan. Gilead once had three promising oncology drugs but sold off the research division in 2001. The company was strapped for cash, and Martin chose to put everything behind Viread—a smart move in hindsight. Now Martin says he's eyeing cancer research again: "We certainly didn't get out because we didn't like it. We liked it very much; we just couldn't afford the investment."

Expect something soon. Martin has a proven eye for a good deal and isn't afraid to do a big one. In 1999 the company acquired Boulder, Colo., biotech NeXstar for \$550 million. At the time, Gilead was valued at only \$1 billion and had \$24 million in revenues. The buy was controversial, but it gave Gilead a European sales force and an anti-fungal drug that generated more than \$200 million in revenues last year. In 2002, Gilead purchased Triangle Pharmaceuticals Inc., which gave the company its second HIV drug, Emtriva. While Emtriva is not the commercial success Viread is, it's a crucial ingredient in Truvada and the upcoming 3-in-1 pill.

Even as Gilead grows into a full-fledged rival of Big Pharma, Martin will never be a flashy, rock-star CEO (despite his healthy \$15 million pay package last year). Last fall, he drove his son to the University of Southern California in a rented U-Haul—after loading up on cheap, self-assembly furniture at Ikea. "He's a very unaffected human being, and that permeates down the organization," Young says. Martin may be down to earth, but he needs to come up with another high-revenue drug. Gilead is counting on it. ■

—By Sarah Lacy in Foster City, Calif.

INTRODUCING A REALLY HIGH-TAR CIGARETTE.

Quite a few people think that smoking pot is less likely to cause cancer than a regular cigarette. You may have even heard some parents say they'd rather their kids smoked a little pot than get hooked on cigarettes.

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According to the National Institute on Drug Abuse, one joint can deliver four times as much cancer causing tar as one cigarette. So if your kids smoke a joint, their lungs

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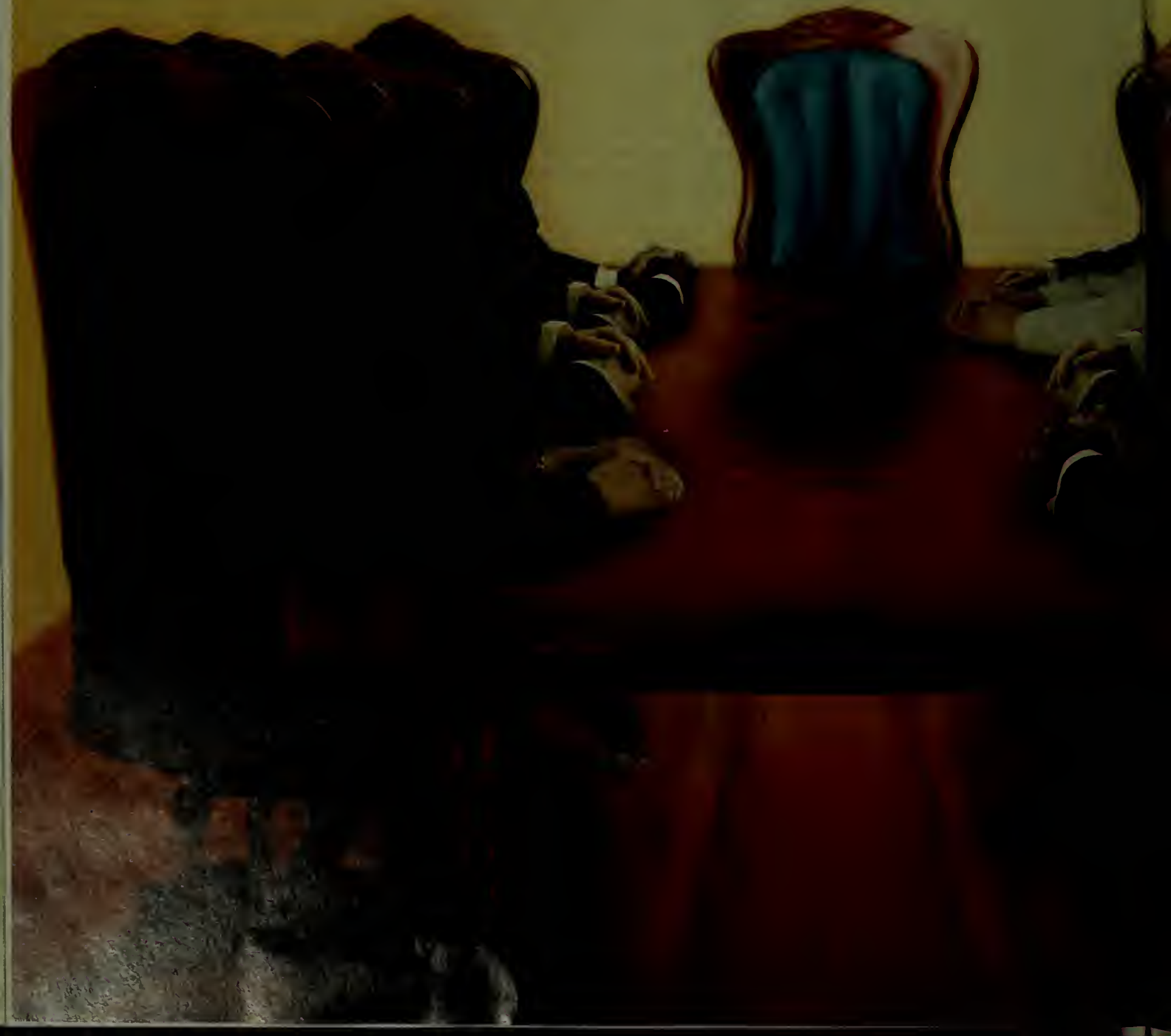
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The **Boss** On the Sidelines

How auditors, directors, and lawyers are asserting their power. **BY DAVID HENRY, MIKE FRANCE, AND LOUIS LAVELLE**

Photo Illustrations by Stephen Webster





If anybody needed proof that the new balance of power in Corporate America has shifted, Maurice R. "Hank" Greenberg provided it on Sunday, Mar. 13. While the imperious chairman and CEO of American International Group Inc. was holed up aboard his yacht on the Florida coast, his company's independent directors were packed into a conference room in their lawyer's Manhattan office. The board members faced an urgent crisis: a growing accounting scandal that seemed to lead straight to the CEO. As directors debated whether to cut Greenberg loose, the 79-year-old titan lashed out at them by telephone. "This board is being run by a bunch of lawyers who can't spell the word 'insurance,'" he shouted. "If you get rid of me, you will destroy this company!" It was the kind of intimidation that had helped Greenberg consolidate unprecedented power in his four decades at the helm of the insurer. But this time, the bullying didn't work. Within a day, Greenberg, once the most powerful man in the industry, was out as CEO. Two weeks later, as the scandal widened, he was forced to resign the chairmanship, too.

Greenberg failed to appreciate the first rule of this new era: that directors, auditors, and lawyers are more powerful than ever. That shift has fundamentally altered relations between CEOs and the advisers they depend on. At their best, these supposed guardians of shareholder value, chosen for their ability to complement the CEO and provide specific areas of expertise, were trusted advisers. At their worst, they were little more than bag carriers and sycophants. Either way, these advisers—who were always supposed to work for the shareholders, not the CEO—usually exercised their power as watchdogs only in moments of genuine crisis. But now the chumminess and banter have given way to a more adversarial attitude. This new cop-on-the-beat mentality has helped to topple Fannie Mae CEO Franklin D. Raines, Boeing CEO Harry C. Stonecipher, Walt Disney CEO Michael D. Eisner, and Hewlett-Packard CEO Carleton S. Fiorina, among others.

The new rebelliousness is also spreading quietly, behind closed doors, to companies large and small that aren't making headlines. Auditor complaints led the initially reluctant board of Molex Inc., a \$2.2 billion electronics manufacturer headquartered near Chicago, to oust its CEO in December. Similarly, accounting problems led independent directors at Delphi Corp. to force out the chief financial officer in March. Dozens of similar dramas are playing out in office towers across the country. Even CEOs who don't lose their jobs are finding that their ability to impose their will, whether it's in setting strategy or hiring a successor, has been severely curtailed.

The reason for the new defiance among directors, auditors, and lawyers is no great mystery: The watchdogs are finally facing genuine liability for their failures. The Big Five in the accounting world became the Big Four after prosecutors effectively put Arthur Andersen out of business for its role in the Enron debacle. Meanwhile, directors at the bankrupt Houston energy giant and WorldCom are paying off fraud claims from their own pockets. That's almost unheard of. In a forthcoming

research paper, a trio of professors from Stanford University, the University of Texas, and Cambridge University report that they were able to find only three prior cases since 1968 in which board members faced financial liability that was not fully covered by insurance. And the Sarbanes-Oxley Act has imposed tough new whistleblowing requirements on everybody—including, for the first time, corporate attorneys.

The upshot of all this is a climate of fear. Directors, auditors, and lawyers are worried, first and foremost, about protecting their hides. The old attitude of informal cooperation with the CEO has been replaced by a new spirit of legalistic, often antagonistic, check-the-boxes formality. When red flags arise, directors are quicker than ever to hire outside attorneys to investigate potential wrongdoing. And the lawyers conducting these probes have been transformed from trusted counselors, who in the past were all too willing to lend their credibility to white washes, into inquisitorial cops.

That often leads to an elaborate game of shift the blame. The rallying cry of the moment: "Put it in writing." Some auditors are afraid even to talk to CEOs and CFOs about the appropriate accounting treatment for complex transactions, reports Philip Livingston, a former CFO at World Wrestling Entertainment Inc. who is audit committee chairman at Insurance Auto Auction Inc. and Cott Corp. "The documentation and paperwork that is being paid for is off the charts," says Livingston.

Pressure On All Sides

CEOs are getting squeezed these days. Advisers who at best were partners and trusted counselors—and at worst enablers—have become adversaries, ready to curtail the chief exec's power at any sign of trouble.

DIRECTORS

Boards used to be hired as much for their golf handicaps as for any other expertise. They read reports from management, offered occasional bits of advice, and generally greenlit decisions the CEO had already made. These days, though, they're apt to become involved in key corporate functions from strategy to succession to auditing. And if there's a difference with the CEO, they'll lawyer up in a heartbeat.

AUDITORS

It used to be a cozy relationship: Audit partners spent so much time on some accounts, they might as well have been on the payroll. And with all the fat consulting contracts, they just about were. Not anymore. Services mostly have been restricted to just the audit, partners rotate accounts more often, and communication with the CEO is all business—sometimes by memo only.

LAWYERS

Once advocates for CEOs and management, now they're more like cops. The change is most visible during independent internal investigations, which frequently were mere whitewashes. These days they resemble inquisitions.

The new environment is making everything about running a company more arduous for CEOs. The watchdogs are playing a bigger role in fundamental management decisions about strategy, acquisitions, succession planning, crisis response, and what can be booked as earnings. "Life is going to be much tougher for the Imperial CEO," says Robert S. Miller Jr., a turnaround specialist who stepped aside as the interim CEO of Federal-Mogul in February and serves on the boards of United Airlines, Reynolds American, Waste Management, and three other companies. "It is what shareholders want," he says. "It is going to be much more difficult today for anyone to pull off the gross accounting scandals of four or five years ago."

CEOs, to put it another way, are now being managed with sticks. This is a fundamentally different corporate-governance philosophy than the one that prevailed during the bubble years, when bosses were primarily motivated with carrots—otherwise known as stock options. (CEOs still make boatloads of money, but these days the upside has been limited and the booty is much more likely to come with strings attached.) Both of these approaches were driven by the business crises that defined earlier decades: the competitive failure of corporate leaders in the 1980s, whose pay was not linked to performance, and the greed of CEOs in the late '90s and early '00s, whose pay was too closely linked to stock prices.

The new vigilance will almost certainly provide some desper-

More on Downsizing the CEO, at BusinessWeek.com

History Repeats Itself: Our illustrated time line reveals how every "solution" to a business crisis simply lays the groundwork for a future problem.

"It's About a Board That Was Deceived": James R. Thompson, head of the audit committee at Hollinger International, talks about ex-CEO Conrad Black and how crucial oversight is in Corporate America.

Q&A with George David, CEO of United Technologies, on dynamics in the boardroom and the often misunderstood role of directors.

BusinessWeek online

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ately needed clarity in corporate governance and cut down on the old abuses. But as is often the case, the new rules may initially go too far and create their own distinctive set of problems. Directors, auditors, and lawyers are all going to command higher fees in the future. And the quality of their advice may well decline. Why? When really tough issues arise—involving risky deals, aggressive regulators, or gray-area accounting—CEOs have always been able to turn to board members and professionals for advice. Now piety reigns supreme, and candid conversations are virtually taboo.

Micromanagement is an equally important danger. CEOs who are always second-guessed by their boards can soon become risk-averse, opting to pursue strategies that are "safe" but ultimately unwise rather than risk confrontations with boards over bolder, but smarter, moves. At a conference last year, Kenneth G. Langone, the Home Depot Inc. co-founder and a central figure in the controversy over Richard A. Grasso's pay at the New York Stock Exchange, warned of the danger that America would have "the best-governed, worst-managed" corporations in the world. "I don't think an adversarial process between management and the board works," says George David, chairman and CEO of United Technologies Corp. "Directors are only able to judge a company at a very high level. The idea that a board will operate 24/7 just isn't realistic."

In a remarkably short period of time, Corporate America has moved from the age of the celebrity CEO to the age of the downsized CEO. With corporate scandals still playing out, there's little chance of CEOs regaining their old clout anytime soon. Here's a closer look at how the balance of power in corporate boardrooms has shifted away from the chief executive:

The Directors

THE BIG QUESTION in the wake of the AIG, Disney, and Hewlett-Packard dramas is how far will boards go in exercising their vast latent power. Under the law, they have the ultimate authority over key policy decisions—whether the CEO embraces their views or not. In the past the issue rarely arose. The



It's **Not** Just AIG

Auditors, directors, and lawyers are showing new resolve at dozens of companies.

COUNTRYWIDE New auditor declares some loan sales improperly booked over a technical issue. Despite CEO's objections, the company restates results. Company pledges to **tighten internal controls**.

DELPHI Audit committee, tipped off by an SEC inquiry, hires investigators to probe accounting problems. CFO quits after board says it has lost confidence in him. The company is **restating its financials**.

ECHOSTAR Acting on a tip, directors order an investigation of company financial controls and discover problems. They push CEO to **discipline an executive and clean up the accounting**.

ELECTRONIC DATA SYSTEMS Auditor KPMG demands more documents to determine how big a write-down to take on troubled assets, delaying quarterly earnings release. KPMG gets its way. Company **takes a \$375 million charge**.

TV AZTECA Outside counsel Akin Gump Strauss Hauer & Feld resigns after broadcaster refuses to disclose transactions with chairman. **SEC files civil charges** against the company, which denies wrongdoing.

Data: Company filings, BusinessWeek research

CEO set the agenda, and while the board may have questioned the boss's decisions, it rarely countermanded them.

It's already clear that directors are getting together more frequently, holding longer meetings, and taking their once-ceremonial duties far more seriously. At E*Trade Group Inc., which revamped its board in 2003 after criticism of then-CEO Christos M. Cotsakos' \$80 million pay package, directors meet four times a year for what it calls "deep dives"—intense discussions lasting up to four hours that give them a chance to interrogate managers about a single topic, such as the one last year that allowed directors to bore into the company's plans for international expansion. "It has been a significant shift," says CEO

Accounting firms have gotten more choosy, dropping companies they deem not worth the time or risk

Mitchell H. Caplan. "When I think about our board today, I think of people who are genuinely concerned about the success of our company."

Even more important, directors at many companies are now required, under recently updated NYSE governance rules, to meet routinely without management present. That is a big threat to the old order. The idea is to allow board members to raise delicate issues—from executive pay and management style to lackluster performance—that they would find difficult to confront with the chief executive in the room. At one of the five boards she serves on, including Dow Chemical Co. and Aetna Inc., former Commerce Secretary Barbara Hackman Franklin recalls that concerns about administrative expenses raised in executive session were relayed to management—and the costs were reined in. "That's the kind of thing that can happen in those sessions," says Franklin.

Directors are taking a more businesslike approach to everything they do. Compensation committees, for instance, used to base the chief executive's pay in large part on studies provided by consultants hired by management—people who often reported to the very chief executives they were evaluating. These days board members are more likely to hire their own experts. When that happens, the whole process changes. The outside advisers are usually invited to reevaluate every element of the

CEO's pay—from bonuses to pensions to deferred compensation to perks, an exercise that makes it more likely that they'll find redundancy. They're also frequently asked to set realistic benchmarks for gauging the chief executive's performance—as opposed to the easily attainable targets that characterized the boom years. "You don't have the free lunch like you had," says New York pay consultant James F. Reda.

Similarly, CEOs are losing the power to anoint their successors, a practice that sometimes allowed insecure leaders to make sure they were never threatened by a high-performing No. 2. Nor can CEOs easily stack their boards with cronies and yes-men. These days nominating committees are hiring their own search firms—and even sometimes rejecting the CEO's choice to fill vacancies on the board of directors. At Chiquita Brands International Inc., the nominating committee is interviewing six board candidates—none of them chosen by CEO Fernando Aguirre. Says committee member Roderick M. Hills: "You'll never get the degree of independence [boards need] unless you get directors who are chosen by someone else."

The committee that is undergoing the most change, though, is the all-important audit committee. Members now meet 8 to 12 times a year instead of just 4. And thanks to Sarbanes-Oxley, they now have the power to spend company money on their own lawyers, accountants, and forensic investigators. The law also makes it clear that the audit committee—not the CEO or the CFO—supervises the auditors. When Chiquita came out of bankruptcy a year and a half ago, Hills, who now heads the audit committee, took quick action to assert control over the auditors. "I called the chairman of Ernst & Young and said, 'We want the résumés of six new engagement partners.' I wanted to make sure that whoever comes—that he knows very well he works for us." The audit-committee chairman says he now gets called in advance if any issues pop up, from accounting questions to consulting agreements. "Historically, that's not what happened," says Hills.

With so much power shifting to audit committees, companies have started hunting for professionals with close ties to the Big Four firms to sit on those committees. The idea is to find advocates who can help resolve disputes between management and auditors. J. Michael Cook, former CEO of Deloitte & Touche, serves on the audit committees of Eli Lilly, Comcast, and International Flavors & Fragrances. If a tough issue arises that requires consultation with an audit firm's national office, Cook says: "I know how to find my way around the halls there. I know the senior partners. I know who to call and who to engage when need be."

Empowered boards have a watchdog mentality that can

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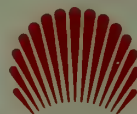
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serve shareholders well—but only if they have top-notch directors serving on them. At a time when boards are being given more power than ever, the top-level management experience of directors has never been lower. A decade ago, sitting CEOs were the first choice to fill board vacancies, and they typically sat on two or three. Today many boards discourage such extracurricular activities, and nearly half of all CEOs sit on no boards besides their own. “You look at boards now, and you wonder who these people are,” says James J. Drury, a Chicago headhunter who specializes in director searches. “I am concerned that boards will be weakened. The best directors will say, ‘I don’t need this.’”

And in addition to all of the virtues of independence, shifting power away from the CEO does have some downsides. It makes it harder for them to put together boards that can compensate for their weaknesses. And while boards need to exercise oversight, chief executives, with their deeper understanding of their

company’s strengths and weaknesses, are often in a better position to make critical strategic decisions. Consider the issue of succession. Many of history’s great CEOs, from General Electric Co.’s Jack Welch to Coca-Cola Co.’s Roberto Goizueta, were handpicked by the leaders they replaced. “There is an increasing desire for boards to take these newfound responsibilities and move into areas where they don’t belong,” says Welch.

The Auditors

ACCOUNTING FIRMS ARE STILL HAUNTED by the ghost of Arthur Andersen. The remaining Big Four firms all face major securities-fraud lawsuits stemming from the corporate crime wave. An even more important legacy of that era is the Public Company Accounting Oversight Board, which has been enforcing tough new standards on auditors. If auditors believe that CEOs and directors are not acting promptly to remedy a material error in the company’s financial statements, for example, they must notify the SEC within 24 hours.

The net effect of all this tumult, ironically, has been to make auditing firms more profitable—and powerful—than ever. The buyer’s market for auditors—in which accounting firms cross-sold consulting services and pandered to clients—has been transformed into a seller’s market. Accounting firms have become much more choosy about which companies they choose to audit, dropping those they deem not worth the time

Directors are quicker to hire outside investigators, who have no incentive to cover the CEO’s tracks

For CEOs, a Year of **Living Dangerously**

These days, there's no riding out a storm. These high-profile execs were forced out of their companies for reasons ranging from failed strategies to ethical breaches. Some key moments:

CARLETON S. FIORINA Hewlett-Packard

The board's request was unequivocal: It wanted Hewlett-Packard Co. CEO Fiorina to elevate Chief Technology Officer Shane Robison to run the company's \$30 billion corporate-computing businesses. But



Fiorina resisted, arguing that it was her job, not the board's, to deploy her top lieutenants. A tense compromise was reached to revisit the issue in March, but on Feb. 7, Fiorina was fired.

HARRY C. STONECIPHER Boeing

Boeing Co. CEO Stonecipher had admitted to having an affair with another Boeing executive. Their sexually explicit e-mails, one source says, "made the Camilla Parker Bowles and Prince Charles tapes



sound like kindergarten talk." On Feb. 28 the board of directors asked Stonecipher to end the affair. He refused. Five days later the board asked him to resign.

MICHAEL D. EISNER Walt Disney

On Mar. 10, Walt Disney Co. CEO Eisner was "ready to climb new mountains." But two days later he was begging to keep his board seat. From a darkened ABC office building, Eisner pleaded by phone for more time, but



the board was unmoved. A rubber stamp until recently, the board was now adamant that Eisner go. Of the nine independent directors, only one was on his side.

or the risk. Big Four firms resigned from 210 public-company clients in 2004, three times as many as in 2001, according to AuditAnalytics.com.

This newfound assertiveness can lead to some bloody show-downs with CEOs—with the boss sometimes losing. Consider recent events at Molex, the Chicago-area electronics maker. The company's auditor, Deloitte & Touche, complained that CEO J. Joseph King and his chief financial officer had not disclosed that they allowed a bookkeeping error worth 1% of net income into the audited results. When the auditor demanded on Nov. 13 that King be removed from office, the board initially stood behind the CEO with a unanimous vote.

Then Deloitte did something unexpected: It quit. Two weeks later the firm wrote a blistering and detailed account of the affair for public disclosure at the SEC. That virtually assured that no auditor would work for Molex again as long as King was in charge. Within 10 days, the directors had eaten crow: They ousted King, promised to hire a new director with financial expertise for their audit committee, and agreed to take training classes in proper financial reporting. The parties involved declined to comment for this article.

In most cases auditors can get their way without such fireworks. Accounting-firm partners say it is much easier now to get companies to make accounting estimates and judgments that are safely right down the middle of ranges, neither too aggressive nor too conservative. When the firms find fault with old accounting practices at one company, CEOs elsewhere in the same or similar industries are apt to get caught in fast-moving waves of financial restatements. In just five months after auditor KPMG changed its mind in November about a decades-old accounting practice followed by fast-food outfit CKE Restaurants Inc., more than 235 companies announced restatements or potential adjustments for lease expenses, according to Jack Ciesielski, an independent accounting analyst. The auditors essentially found that companies were understating lease expenses or accelerating credits, both of which inflate earnings.

The risk is that accounting firms will apply rules so strictly that financial reports become less useful to investors. Audit partners are pushing companies to restate financial reports for

smaller amounts, sometimes over debatable issues. At Countrywide Financial Corp., auditor KPMG pushed the company to restate earnings because the company still held 0.1% to 2.2% stakes in assets it said it had booked as sold. Restatements such as those become a distraction for investors. At the same time, companies are loading up reports to the SEC with more informational text than most anyone can read. The average annual 10-K report from companies in the Dow Jones industrial average is 198 pages long, nearly double what it was six years ago, according to David Zion, an accounting analyst at Credit Suisse First Boston. Some companies have disclosed, even when not required, that they had weaknesses in their bookkeeping that had only a remote chance of affecting their financial statements. This type of excessive caution is far more highly valued by the Big Four's legal counsel than by investors.

The Lawyers

LAW FIRMS HAVEN'T SUFFERED as seriously as accounting firms in the wake of Enron, WorldCom, and the other major corporate scandals. No attorneys have gone to jail for the advice they offered to the major rogue CEOs, no law firms have been driven out of business for assisting fraudsters, and private litigation has not proven to be a huge threat to business counselors.

But that doesn't mean things are unchanged in the legal world. Attorneys are no longer treating CEOs and general counsel as their most important patrons. Like accountants, attorneys are now more likely to be hired by directors—and more important, to behave as if their true clients are shareholders. This new attitude is most visible in the way lawyers conduct "independent internal investigations"—such as the ones that played big roles in the downfalls of AIG's Greenberg, ex-Computer Associates International CEO Sanjay Kumar, and many others.

In the past these internal probes often turned out to be little more than whitewashes. Directors commissioned them in large part because *In Re Caremark*, a key 1996 Delaware Chancery Court decision, obligated them to investigate alleged

THE I'M TIED TO
MY DESK BOA IS OVER

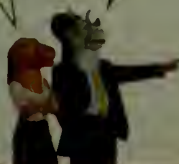


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tions of misconduct. But it was often easy for CEOs and other high-ranking managers to manipulate the supposedly neutral process by turning to friendly attorneys “who would develop a strategy to cut off the problem at the lowest level that could be sold to the outside world,” says Edwin H. Steir, a former federal prosecutor who is the author of *Corporate Internal Investigations: Independence and Credibility*.

The big problem was that lawyers are not trained to be objective investigators. Their natural instinct is to serve as advocates for the people paying their bills. Even after the *Caremark* decision, lawyer-investigators sometimes agreed to conditions that undercut their effectiveness, such as allowing corporate executives to edit the prober’s reports or sit in on witness interviews—a strong disincentive to whistleblowing. Taking advantage of the attorney-client privilege, lawyers also generally kept all of their underlying research under wraps and offered regulators only a written summary of their conclusions.

Public disenchantment with corporate crime has certainly generated pressure to tighten standards for internal investigations. But another, comparatively unheralded factor has turned out to have a much greater impact: the renewed interest of the U.S. Justice Dept. in bringing criminal charges against companies, as opposed to individuals exclusively. This was articulated in a little-noticed January, 2003, policy memo written by then-Deputy Attorney General Larry D. Thompson entitled *Principles of Federal Prosecution of Business Organizations*.

The memo immediately caught the attention of corporate defense lawyers. Merely being charged with a crime amounts to a death sentence for some corporations—especially those businesses that are built on public trust or that have to meet tough government vendor requirements. “If you are a financial-services company, if you are a defense company, if you are a drug company, or if you are in a whole host of other industries, the consequences of an indictment are so serious that you won’t even make it to trial,” says William McLucas, a Washington lawyer who conducted the internal investigations for directors in the aftermath of the Enron and WorldCom debacles.

The good news for Corporate America, though, was that the Thompson memo showed directors exactly how to avoid this awful fate. One way was to show a “willingness to cooperate in the investigation” of corporate employees. Another was to waive the attorney-client privilege that would ordinarily cov-



By and large, the CEO is still in charge, but the days of the imperial chief executive are over

er internal corporate investigations. These same general guidelines have also been followed by other federal agencies and the states.

The Thompson memo—along with the broader enthusiasm state and federal prosecutors have displayed for corporate criminal charges—has essentially killed the old whitewash machine. When companies face charges of serious wrongdoing, the first thing directors generally do is instruct employees to cooperate with regulators. The second thing that happens is that the board agrees to waive the attorney-client privilege for any damaging material uncovered by lawyer-investigators. This means regulators get to see every witness transcript, scrawled note, and smoking-gun e-mail that the company sees.

The upshot: CEOs and other executives can no longer regard the lawyers conducting internal probes as advocates in disguise. These days the investigators function much more like cops. Any doubt about the issue was eliminated last year when CA’s Kumar was indicted on obstruction-of-justice charges for the alleged crime of lying—not to regulators, but to internal investigators.

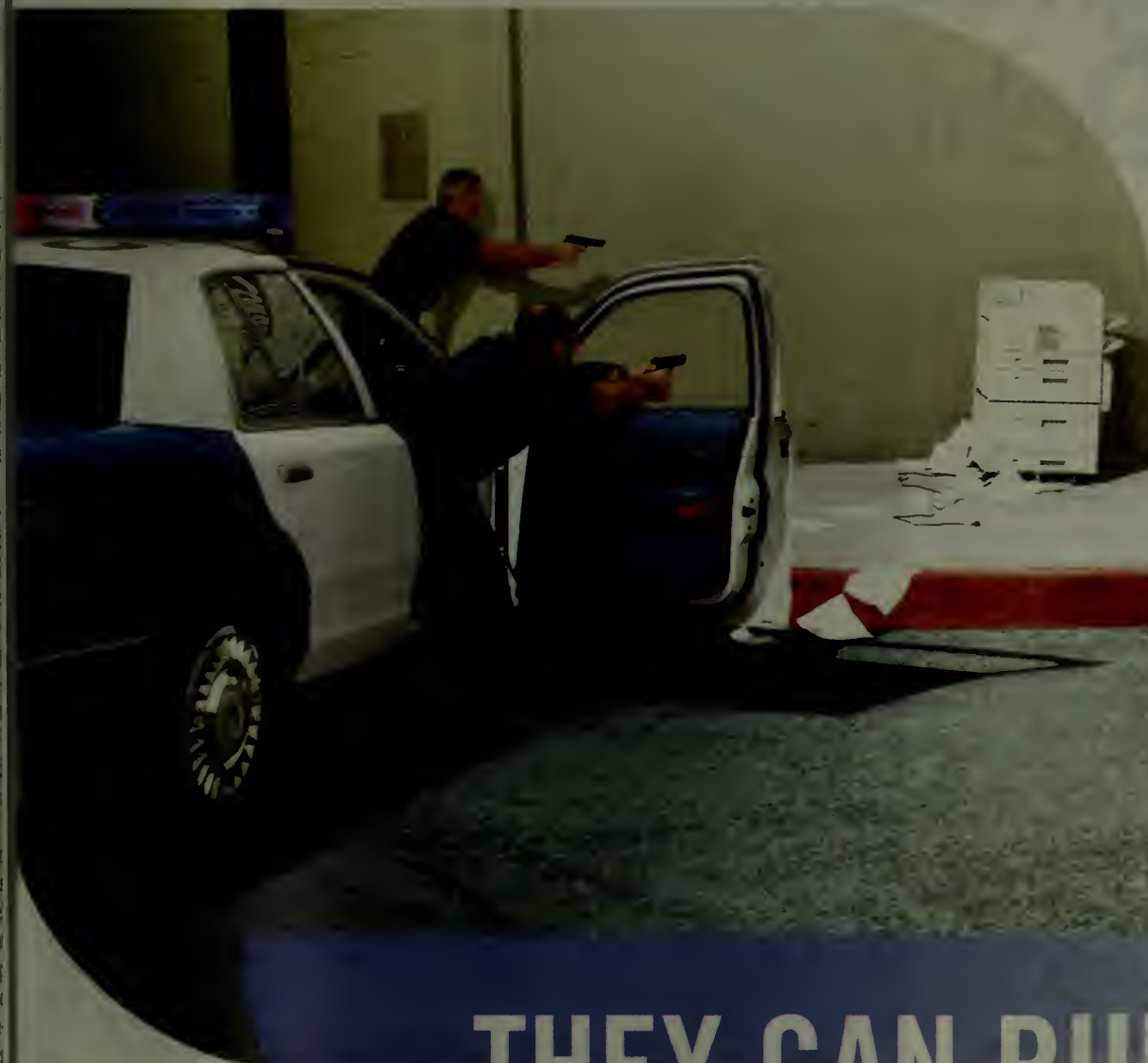
Now everybody up and down the management hierarchy needs to retain their own counsel when a probe is launched. That adds to the already massive troop deployments that characterize contemporary internal investigations. Consider superlawyer David Boies’s investigation of Tyco International Ltd. He assigned 25 attorneys and 100 accountants to the job. Then forensic SWAT teams circled the globe, digging through file cabinets and hard drives and interviewing employees at 45 operating units in 13 countries. In all, more than 15,000 lawyer hours and 50,000 accountant hours were billed to the probe. Once such a large investigation is set in motion, “the CEO is no longer in charge,” observes corporate lawyer Michael R. Young, of Willkie Farr & Gallagher in New York.

By and large, of course, chief executives are still in charge, but their power is much more limited. The downsizing of the CEO has led, to a certain extent, to the supersizing of the advisers. That’s not necessarily a cure for everything that ails Corporate America. It is a clue that successful CEOs will have to be consensus builders in the future. And should be a warning to CEOs everywhere: The age of the absolute corporate monarch, such as AIG’s Greenberg, is over. ■

—With Diane Brady in New York, Joseph Weber in Chicago, and bureau reports

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Tough Love For Debtors

Credit-card rules that raise minimums could hurt consumers—as well as banks

LIKE A LOT OF AMERICANS, Robert and Jill Proctor of Kansas City, Kan., are getting hammered by credit-card debt. When Robert lost his job two years ago, the thirty-something couple ran up \$35,000 on 10 different cards just to pay everyday expenses like groceries and gas. Even after Robert found work last year as a country club manager, their combined income just covers monthly outlays for two cars, a mortgage, and credit-card bills on top of household expenses. Says Robert, who makes minimum payments on the cards with the biggest balances as he struggles to pay off the smaller ones first: "If they tack on more charges, we'll be stuck."

That's just what's about to happen. Because of a crackdown by the Office of the Comptroller of the Currency, most banks and credit-card issuers will ratchet up required minimum monthly payments over the next 12 months or so. In the future, the payments must cover all fees and interest and pay down at least some of the outstanding borrowing. The goal is to help people pay bills faster and slash the interest due. Monthly payments on many cards will double, to about 4% of balances, say card experts. Barbara J. Grunkemeyer, deputy controller for credit risk for the OCC in

Washington, explains: "We were concerned that people were making smaller and smaller payments, but not making any headway" in paying off loans.

The new rules will hit consumers hard, especially on top of higher energy prices, rising interest rates, and record levels of overall household debt, now \$10 trillion, or 87% of gross domestic product. American households, on average, possess nearly eight major bank cards—or 17, including store and gas cards. Either by choice or necessity, some 19 million households—about one in six—now make minimum payments on their cards, according to card tracking service CardWeb.com. "The main concern is that there could be an increase in defaults and personal bankruptcies," says Michelle Grabow, credit-card research manager at Informa Research Services Inc. That in turn would hit banks' bottom lines as they have to charge off more loan losses. Worse, the shrinking of families' disposable incomes as they step up repayments could put a crimp in consumer spending. The massive indebtedness of Americans is a "huge macro risk factor for the U.S. economy," warns Stephen S. Roach, Morgan Stanley's chief economist. "The debt bomb is ticking."

In fact, banks were so worried about the potential impact on their businesses

that they persuaded the OCC to give them a long transition period before applying the rules, originally published back in January, 2003. Their fears seem justified. Bank of America, one of the first issuers to raise minimums, in the second quarter of 2004, saw net charge-offs for bad loans soar 63%, to \$691 million, though by the end of that year only \$40 million was related to the increased minimums. It also increased loan-loss reserves by 21.1%, to \$170 million. That surprised some analysts because the Charlotte (N.C.) bank had told them that hikes in payments amounted to a modest \$10 to \$20 per month for most cardholders. Says David A. Hendler, a bank analyst with researcher Credit-Sights: "It seems that even a small monthly increase in minimum payments can cause some borrowers to tip into default."

MINIMAL IMPACT?

SO FAR, BOFA, Citigroup, Discover Card, and MBNA—which together issue some 275 million of the 658 million general purpose cards in circulation—are among those with timetables for raising their minimums. JPMorgan Chase & Co., with roughly 96 million cards, will "experiment" with higher minimums later this year on a "small portion" of its customers, according to Ray Fischer, chief financial officer of JPMorgan Chase Card Services. Fischer says 90% of the bank's customers make more than the minimum payments. The New York bank is not sure just what the financial impact will be. Still, it reported in a recent filing that it, too, is bracing for more delinquencies and charge-offs.

Some issuers continue to insist that the impact will be small. At Wilmington

Credit Crunch

Lite will get tougher for the 19% of households who make only the minimum payments on their credit cards

BIGGER MINIMUM MONTHLY PAYMENTS

Cardholders will have to pay at least some of what they owe, not just interest. Minimums could rise from 2% to 4%, increasing a \$200 monthly payment on the average \$10,000 balance to \$400.

MORE LATE FEES

Cardholders who can't pay on time face penalties. But if these fees push a balance over the account's credit limit, cardholders are hit with yet another \$25 to \$39 fee. A delinquent must pay higher interest rate



Del.)-based MBNA Corp., new cardholders will have to pay higher minimums starting in July. Existing customers will receive notices in September and see changes soon after. They'll have to pay interest and late fees, if they have them, plus 4% of the remaining balance. Currently, MBNA customers have to pay interest and fees plus \$15, or 2.25% of new balances, whichever is less. MBNA spokesman

CREDIT

payments on one card may trigger rates on others. Delinquencies are recorded on credit histories used by credit agencies and may curtail borrowers' ability to borrow.

James Donahue says the change "won't have a practical impact" since most cardholders make the minimums.

That doesn't mean MBNA and others won't be stung by the extra vigilance of the OCC. It has also warned banks that they must consider substantially reducing interest rates—which quickly jump from introductory offers of 0% to an average of 16%, according to CardWeb.com—or eliminating fees so that more of cardholders' monthly payments go to cutting their balances. Banks haven't been "overly keen about the prospect, but we needed to keep the pressure on," says the OCC's Grunkemeyer. No wonder. Last year, credit-card issuers reported record profits of \$30 billion—much of it earned on liberal lending policies and punishing fees

that often exacerbate the financial woes of cardholders who have gotten in over their heads. Borrowers who make a late payment—whether it's for the phone bill, a credit card, or a house payment—often are charged punitive rates averaging 29% on all their cards. These on-the-edge borrowers are the most profitable part of any bank's card operations, as long as they don't default.

TAKING THE LONG VIEW

TO MAKE MATTERS WORSE for banks, consumer groups and legislators are pressing them hard to disclose more on monthly card statements about minimums and fees. Senator Chris Dodd (D-Conn.) reintroduced the Credit Card Accountability Responsibility & Disclosure Act in March, after a stalemate in 2004. The bill seeks, in part, to force credit-card companies to say how long it would take to pay off outstanding balances if customers just pay minimums, and how much interest they would pay over the life of the loan. California enacted a similar law three years ago, but "it's not being enforced," laments Tom Dresslar, spokesman for State Attorney General Bill Lockyer, because the banks argue that federal rules preempt the state law.

If customers saw exactly how much credit was costing, they might be more inclined to pay higher monthly amounts voluntarily. Consider a customer who has a \$10,000 balance with a 16% interest rate, and who makes a 2% minimum monthly payment. It will take more than

Higher payments may tip many into default

40 years to pay off the balance and cost \$19,329 in interest. With a 4% minimum, the loan is paid in about 14 years, and interest costs are \$4,931.

The full impact of the OCC rules depends on whether customers

can pay the new minimums. What is certain is that once banks implement the changes, they have 180 days to charge off any bad loans that result. "The hope is that there'll be only a temporary increase as you push those customers over the edge and they default," says David L. Fanger, a banking and finance analyst with Moody's Investors Service. If so, that would be a big relief for banks, strapped American consumers, and the U.S. economy. ■

—By Mara Der Hovanesian
in New York

Media Wildcatter

Anschutz is bringing his contrarian style to newspapers and films



BY THE TIME THE IDEA of making a movie about the life of singer Ray Charles was pitched to Philip F. Anschutz, just about every major Hollywood studio had passed on it. Young people wouldn't know Charles, producer Stuart Benjamin was told. And biographies of African Americans don't sell well, the naysayers added. Even Anschutz' advisers said it would be better as a TV movie. But the 65-year-old financier, a longtime Charles fan, went with his gut and backed the film with \$37 million. *Ray* went on to score two Oscars—including best actor for Jamie Foxx—and gross \$125 million at the box office.

In an investment career that started with oil back in the 1960s, Anschutz has usually zigged when others zagged. The contrarian strategy has paid off handsomely: Today he's worth an estimated \$5 billion. And although he's now investing in high-profile businesses such as movies, sports teams, and daily newspapers, Anschutz is still doing much the same thing—finding out-of-favor assets and figuring out a

way to build them into something. "Nobody is better at winning long-shot gambles," says newspaper magnate William Dean Singleton, a friend of Anschutz.

Anschutz and his 10-person investment staff work on the 24th floor of an office tower his family owns in downtown Denver. What persuades them to pick one counterintuitive deal over another? He won't say. Following a long-standing policy of not talking to the press, Anschutz declined to comment for this article. A devout Christian and a heavy contributor to Republican politicians, he has had some media watchers speculating that he will use his newspaper and entertainment ventures to promote a conservative agenda. But Robert F. Starzel, a longtime Anschutz executive who is now chairman of the *San Francisco Examiner*, says his investments are strictly about the bottom line: "Phil's strategy is to meet a challenge and make money."

At the same time, Anschutz gives the managers of his various operations enormous leeway. "I speak with him once a week, but it's pretty much like we're running an independent business," says Timothy J. Leiweke, chief executive of

Anschutz Entertainment Group Inc., sports and live-events unit.

Sometimes his hands-off style can lead to problems. Qwest Communications International Inc., which he founded in 1988, became tarred with a financial scandal that forced it to lower its reported profits by \$2.5 billion for 2000 and 2001. The Securities & Exchange Commission has charged seven former Qwest executives—including former Chairman and CEO Joseph P. Nacchio, but not Anschutz or other board members—with orchestrating a massive accounting fraud. All seven maintain their innocence.

OUTFLANKING RIVALS

MEANWHILE, QWEST IS involved in a battle to snare MCI Inc. away from Verizon Communications Inc. Anschutz still owns 18% of the stock; it's worth about \$1.1 billion, down from \$17 billion at its height in 2000. He had previously reaped \$1.9 billion, selling 17% of his stake.

Anschutz' gutsiest bet right now is in newspapers. Last year he picked up the money-losing *Examiner* for \$20 million. Once the launching pad for William Randolph Hearst's empire, the 145-year-old *Examiner* had long been in decline as the city's second major paper. Last fall, Anschutz bought Journal Newspapers Inc., publisher of three struggling dailies

His gutsiest bet is in newspapers, where very few startups have lasted

suburban Washington, D.C., for an undisclosed sum. He relaunched them Feb. 1 under the *Examiner* masthead. Together the papers, which are distributed for free, form the core of a new company, Denver-based Clarity Media Group. Thinking long-term, Clarity has trademarked the *Examiner* name in 60 cities.

Clarity's strategy is to outflank newspaper rivals by targeting the readers advertisers most want to reach—young, college-educated homeowners in the most affluent zip codes. Thanks to Anschutz' deep pockets, Clarity has doubled the daily print run to about 162,000 copies in San Francisco and 266,000 in Washington. By blanketing a neighborhood with free copies, Clarity can claim it is reaching readers who don't subscribe to Brand X.

"We feel like we're hitting some markets we wouldn't be hitting in the [San Francisco] *Chronicle*," says Jennifer MacCloskey, marketing director for Wells Fargo & Co. in the Bay area.

The big question is whether Anschutz can generate enough revenue to cover his publishing and distribution costs. Clarity admits that some residents have asked it to stop the free deliveries, contending that the free bones, tabloid-style papers clutter their driveways. Clarity officials are tight-lipped about how much money they plan to spend before they expect to turn a profit. But the track record of newspaper startups is poor. "No effort to establish a new daily newspaper in a U.S. city has worked [in decades]," says veteran newspaper analyst John Morton. "It's a very expensive proposition."

Anschutz used a similar buy-build strategy in his sports and live-entertainment businesses. In 1995, with a partner, he acquired the Los Angeles Kings hockey team in bankruptcy court for \$113 million. He later bought an interest in basketball's Los Angeles Lakers and built them both a \$400 million arena, the Staples Center, in downtown Los Angeles. Looking to fill the property on off nights, he bought some local promoters and formed a concert-booking outfit. Today, Anschutz Entertainment Group is the nation's second-largest promoter of live

events, after Clear Channel Communications Inc. And Anschutz is also considered the savior of U.S. professional soccer, stepping up to buy as many as six of the league's 12 teams when the circuit ran into financial trouble.

Anschutz is still looking to expand his entertainment business. He hopes to build a concert venue inside the vacant Millennium Dome near London, an effort others have passed on. He's spending \$35 million to stage a Tour of California bike race, modeled after the Tour de France, next year. And he's spearheading a \$1 billion development next to the Staples Center that will include a 55-story hotel, theaters for movie premieres, and a music museum showcasing the Grammy Awards.

In Hollywood, Anschutz also found a

creative way to enter the business. Five years ago he and partner Oaktree Capital Management LLC began buying up the bank loans of three overextended theater chains. After putting them through bankruptcy so they could reduce debt and drop expensive leases, Anschutz merged them to form Regal Entertainment Group, now the nation's largest cinema operator, with 6,500 screens. Last year it earned \$334 million on sales of \$2.5 billion.

HIT AND MISS

AFTER NOTICING THAT G- and PG-rated movies made more money than R movies, Anschutz began bankrolling family-friendly films. While his PG13-rated *Ray* was a hit, he also has had some major flops, including last year's *Around the World in 80 Days*, which cost \$110 million and grossed just \$75 million at the box office.

Long ago, Anschutz discovered that he had a knack for finding value where others didn't. The son of a Kansas wildcatter, he made his first fortune buying up ranch land in the Rockies and drilling for oil. In 1982 he sold his half-interest in Wyoming's Anschutz Ranch East field for \$500 million. At the same time he began investing in railroads, an industry long under pressure from trucking. After buying the Denver & Rio Grande and the Southern Pacific, Anschutz sold both to Union Pacific Corp. for \$5.4 billion in 1996. In the process, he kept the rights of way, which he used to build Qwest.

Despite his billions and his increasing reach into glamorous industries, Anschutz remains a humble, low-key man. At a party last year celebrating the *Examiner* purchase, John Burks, head of the journalism department at San Francisco State University, asked Anschutz whether the newspaper might be able to hire some of his students as interns. Anschutz turned the question around, asking Burks instead whether he might be able to take journalism classes. Anschutz hasn't appeared in Burks' classroom yet. Given his long career investing in different industries, it looks as if he prefers on-the-job training. ■

—By Christopher Palmeri in Los Angeles

Phil's World

Billionaire Phil Anschutz made a fortune in oil, railroad, and telecom companies. Now he's amassing media and entertainment properties.

NEWSPAPERS Anschutz bought the 145-year-old *San Francisco Examiner* last year. He launched a similar free daily in Washington (D.C.) this year and has trademarked the *Examiner* name in 60 cities.

MOVIES Last year his film companies produced the Oscar-winning *Ray* as well as one of the biggest bombs, *Around the World in 80 Days*. He began investing in cinema chains in 2000 and now controls the 6,500-screen Regal Entertainment, the nation's largest cinema operator.

LIVE ENTERTAINMENT Anschutz Entertainment Group is the nation's second-largest event promoter, producing everything from Celine Dion's show in Las Vegas to the upcoming King Tut museum tour. It also owns stakes in basketball's Lakers and hockey's Kings and owns Los Angeles' Staples Center, where the teams play. He is spearheading a \$1 billion development in downtown L.A. dubbed Times Square West that will include theaters and a music museum.



SPORTS Lakers' Bryant



FILMS Foxx in *Ray*



SHOWS Celine Dion

Data: BusinessWeek

From Mom and Pop To Megafund

Can family biz Calamos keep Wall Street happy while boosting investor returns?

WHEN JOHN P. Calamos Sr. started buying convertibles in the 1970s, most investors thought of cars, not bonds. Today companies issue more than \$70 billion of such debt each year, and his firm, Calamos Asset Management Inc., puts more money into these hybrid securities than just about any other mutual-fund company. Calamos used that expertise to branch out into equities and then high-yield bonds. In fact, since the tech bubble burst, the firm's assets have expanded by an astounding 750%, to \$38.2 billion. Returns have kept pace with the growth: All six of its mutual funds that are at least five years old rank in the top 25% of their category over that period.

For all its success, though, this is a precarious time for Calamos. Late last year the 64-year-old money manager took his family-owned company public. That means he must serve two masters—company shareholders and fund investors—whose interests may not always be in sync. But his bigger challenge may be keeping up the firm's performance after years of tremendous growth.

The initial public offering was a big success, raising \$414 million. And the stock has soared 24%, to around \$22 a share. The listing makes it easier for the Calamos family to pay any estate taxes and gives the company the money to help seed new products. The firm, which is building new headquarters outside Chicago, launched an international mutual fund



this year, and is developing another hedge fund. Still, it has to avoid the pitfalls some listed fund companies have fallen into by rolling out trendy products to chase hot money, raising fees, or taking other actions to please Wall Street. "When someone goes public they're in business for their shareholders, which is antithetical to the fulfillment of their fiduciary duty," says John C. Bogle, founder of the Vanguard Group. "Calamos is going down a difficult road."

THE STAT

142%

Annualized growth in Calamos' fund assets since 1999

Data: Financial Research Corp

CALAMOS "Fund investors and shareholders are very much aligned"

Calamos says his firm won't lose sight of its roots. In fact, it's still a family business even though it trades on NASDAQ. The Calamos clan has more than \$250 million invested with the firm, and owns 77% of the company. "The interests of fund investors and shareholders are very

much aligned," he says. "You don't have to forsake one group for another."

Public or not, it's much easier for a lead fund to shine than one that has put on weight. Calamos' largest offering, the \$14.3 billion Calamos Growth Fund, ranks in the top 1% of all mutual funds since 1995, with an annualized return of 23%. Much of the gains were made when the fund had less than \$1 billion in assets. For the past year it's in the bottom half of its category. "Savvy stockpicking served them well, but can they keep it up as assets grow?" asks Kerry O'Boyle, an analyst with Morningstar Inc. The fund's high costs are also a drag: Their asset-weighted expenses average 1.55%, versus 0.89% for the industry.

The firm promises to avoid the trap of keeping funds open to new investors for too long. John Calamos' nephew, Chief Investment Officer Nick I. Calamos, says it will close a fund that's becoming too unwieldy. They've done this with two others: Calamos Convertible Fund and Calamos Market Neutral Fund.

FAMILY VALUES

JOHN CALAMOS got his first taste of investing as a teenager in the 1950s. His Greek immigrant parents' idea of saving was to squirrel away in a cigar box each silver dollar that passed over the counter of their Chicago

grocery store. So it wasn't easy to persuade them to give him \$5,000 to try his hand at the market. He bought a few growth stocks, with mixed results: Texas Instruments Inc. tripled in value, while Muntz TV went to zero. His parents, along with a dozen or so other relatives, were among his first clients when he set up shop in 1977. "Not losing your parents' money and not losing money for the people who trust you is paramount to investing," he says. If the firm ever loses sight of that maxim, the Calamos clan will likely have something to say about it. ■

—By Adrienne Carter in Naperville, Ill.

BusinessWeek online For a Q&A with money manager Nick Calamos, please visit us online at www.businessweek.com/extras



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BIO

Jay Alan Sekulow

Chief Counsel,
American Center for
Law & Justice

Founded by Pat Robertson in 1990, the center is the leading advocacy group for religious freedom. Sekulow has argued a dozen cases before the Supreme Court, clearing the way for public school students to form Bible clubs on school campuses and defending the free-speech rights of religious groups. He also has a talk-radio show with a daily audience of some 1.5 million listeners.

Inside Bush's Supreme Team

In the fight for the courts, three behind-the-scenes players are uniting the Right

JAY SEKULOW IS BEST known as the nation's top legal advocate for all causes Christian. But on this sunny afternoon, broadcasting from a basement radio studio a block from the U.S.

Supreme Court, the booming voice of religious liberty is making a case for moderation. On the air is Tom from Texas, calling for a nationwide campaign to impeach judges who make "outlandish rulings." Sekulow cuts him short. "You can't impeach a judge just because you disagree with their decisions," Sekulow admonishes. "I don't think that's wise."

His socially conservative listeners, riled over a string of court rulings affirming gay marriage and defending the right to die, might beg to disagree. But part of Sekulow's job these days is to keep a lid on the radicals without losing their support. As one of three top strategists

tapped by the White House to help steer President George W. Bush's judicial nominees through a closely divided Senate, Sekulow will have to rely on political pragmatism as much as he does on the passion and power of his 1.5 million socially conservative listeners.

With a Supreme Court vacancy all but certain this year, true-blue liberals, rabid conservatives, and activists of every stripe are amassing millions of dollars and mobilizing thousands of true believers for an air and ground war expected to eclipse every other legislative issue on the congressional agenda—including Social Security and tax reform. Already the ideological struggle over the high court and the federal appellate bench has squelched scholarly dis-

course on jurisprudence and replaced it with a partisan free-for-all that feels like a bruising election-year campaign, mudslinging and all.

COVERING THE BASES

THE THREE GENERALS leading the Republican rank and file into battle are working informally and have no official titles, but each represents a core constituency of the GOP. While Sekulow, 48, rallies Evangelical America with his daily radio show and Internet appeals, former White House counsel C. Boyden Gray, 62, has the business community jumping into the judges' fray for the first time. The Committee for Justice, an advocacy group he created in 2002 to rally corporate support for Bush nominees, has amassed a multimillion-dollar lobbying and advertising budget. Gray will air TV ads (if necessary), help the White House coordinate with the Senate, and advise on procedural strategy. He'll draw heavily from his experience under the first President Bush, when he helped Clarence Thomas navigate confirmation hearings and move on to the Supreme Court. "Thomas was confirmed, but we were scrambling like mad," Gray says. "We didn't have a good outside infrastructure, a network of support like we hope to [have]...this time around."

Rounding out the triumvirate is an unassuming, bespectacled wonk, Leonard

The struggle over the bench has turned into a partisan free-for-all



WHEN THE INFORMATION NEVER STOPS, NOTHING CAN STOP YOUR BUSINESS.

business, keeping people and information connected is critical to keeping customers satisfied. And yet, at any given moment, any number of events can easily derail that connection. That's why you need a company like SunGard on your side. Our Information Availability Solutions provide redundant systems and networks at over 20 secure facilities worldwide to make sure your customers, employees and suppliers stay connected 24/7. And at the same time keep your IT staff in complete control of your data and applications. So while you're busy running your business, we're busy making sure your business is up and running. No matter what.

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A. Leo, 39, executive vice-president of The Federalist Society. Credited with transforming the Federalists from a sleepy debate club into a conservative powerhouse that challenges liberal orthodoxy in Washington and on law school campuses, Leo has a deep institutional knowledge of the legal community and its top thinkers. He is vetting potential nominees not only for their conservative philosophy but also for their intellectual heft. He can call on two Rolodexes—one packed with legal contacts, the other with contacts made as Bush's liaison to Catholics during the 2004 Presidential campaign. "He's a guy who can divide the sheep from the goats," says Robert P. George, director of Princeton's James Madison Program in American Ideals & Institutions. Leo is overseas and declined to comment for this story.

THE SCALIA MODEL

NO SINGLE litmus test—be it abortion, tort reform, or states' rights—could easily unite these three men and satisfy their diverse constituencies. What they share is a belief that judges should hew to the letter and intent of the Constitution and ignore shifting cultural mores, international law, popular opinion, and other outside influences. That legal philosophy, known loosely as constitutionalism and best personified by Supreme Court Justice Antonin Scalia, is a reaction to what conservatives call decades of liberal judicial activism, beginning in the 1960s under Chief Justice Earl Warren.

Using a broad judicial philosophy rather than fundamental policy disagreements as a rallying cry is a recognition by party leaders that no single appointee can

No single litmus test can satisfy all Republicans

meet all the demands of the GOP's Big Tent while gaining enough support to pass muster in the politically supercharged Senate. It's an acknowledgment, too, that many Republican appointees in recent decades, such as Supreme Court Justices David H. Souter and Sandra Day O'Connor, have been profound disappointments to party regulars despite their GOP bona fides. "No one can fine-tune an individual judge's reaction to a set of issues, and you certainly can't do that with dozens of nominees," Gray says. "The various interest groups agree that it's better to have judges who will not try to run the country from the bench, and leave the legislating to [Congress]. A lot of people can unite over that."

Gray coordinates weekly conference calls with leaders of some 200 conservative causes, such as the Family Research Council, Americans for Tax Reform, RightMarch.com, the National Pro-Life Action Center, and the Republican National Lawyers Assn., to plan strategy and exchange information. He, Leo, and Sekulow confer regularly with Tim Goeglein, White House deputy director of the Office of Public Liaison. The loose coalition takes a page from the playbook of civil rights and special-interest groups on the Left, including the Alliance for Justice and People for the American Way (PFAW), which successfully organized in 1987 to block the confirmation of Supreme Court nominee Robert Bork.

This time around, the Right's network rivals the Left's in sheer size and could outpace it financially as well, given the deep pockets of many of its allies, especially in the business community. Gray's soirees are sought-after invitations on the Washington party circuit, and his Georgetown manse has hosted Senate Majority Leader Bill Frist (R-Tenn.), Bush confidante Karen Hughes, and other GOP highfliers. Last year, Gray persuaded George P. Bush, the President's nephew, to headline a Committee for Justice fundraiser. "These individuals get two bites at the apple," says Nan Aron, president of the Alliance for Justice. "By supporting Bush's court-packing agenda, they curry favor with the Administration and also get Big Business and special-interest judges confirmed who will render decisions sympathetic to them."

Like Aron and Ralph G. Neas of PFAW, Gray, Sekulow, and Leo will serve as megaphones to party regulars, educating

their constituencies and persuading them to support Bush's picks, however spotty their records might be on a particular ideological issue. "What you've got here in all three cases are principled pragmatists," says Princeton's George. "None of these men are people that movement conservatives would write off as mere pragmatists. On the other hand, none of them are people that practical politicians would write off as ideologues."

Their first order of business is to give political backing to Frist as he tries to change Senate rules and make it more

BIO

Leonard A. Leo Executive Vice-President, The Federalist Society

Leo turned a sleepy debating club into a political and academic force that serves as a training ground for conservative nominees. He was named to coordinate Catholic outreach for the RNC after helping win 52% of the Catholic vote for Bush in 2004. Leo is also a delegate to the U.N. Commission on Human Rights.



difficult for Democrats to block Bush's judicial nominees. To that end, Sekulow is using his radio show to collect petitions supporting the "nuclear option," so named because Dems have threatened a legislative meltdown if Frist follows through on his promises. Federalist Society members are providing some of the intellectual ammo Frist needs to make his case. And Gray is hitting the TV talk shows and preparing to air ads that will be rolled out if Frist needs help corraling the final few votes for a rules change.

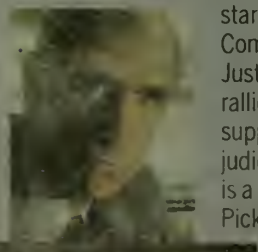
Neas and his allies don't underestimate the political clout of Gray & Co. "They have access to tremendous wealth," Neas says. "We have a titanic battle shaping up." Intellectually, however, liberals dismiss the GOP court push as little more than cultural conservatism masquerading as a judicial philosophy. That could be a mistake. If Bush's judge-vetting triumvirate succeeds in persuading the disparate groups on the Right to subordinate their individual concerns to an overarching approach to jurisprudence, the courts could be in for a new era. ■

—By Lorraine Woellert in Washington

BIO

C. Boyden Gray Chairman, Committee for Justice

As White House counsel to Bush I, Gray helped Clarence Thomas win confirmation. His think tank, Citizens for a Sound Economy, advocates lower taxes, less regulation, and free trade. In 2002, Gray



started the Committee for Justice, a group that rallies corporate support for Bush's judicial nominees. He is a partner at Wilmer Pickering Hale & Dorr.

A man in a dark suit, white shirt, and red tie stands with his arms crossed. He is positioned in front of a city skyline, with the Transamerica Pyramid being the most prominent building on the right. The scene is set outdoors with some greenery in the foreground.

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A Nest Egg That's a No-Brainer

Automatic 401(k)s are taking hold—and getting employees to salt more away

WHEN HIS OIL refinery in Big Spring, Tex., changed hands in 2000, Alton Fields, a 58-year-old engineer, cashed out his 401(k) and invested the money himself. The new owner, ALON USA, offered its own 401(k), but Fields never bothered to sign up. “At my age, I thought I was smart enough to put my money in the right place,” he says.

But this year ALON changed its plan for its 260 workers. It now automatically enrolls them, signing them up to con-

tribute 3% of pay unless they take the trouble to opt out. ALON also hired Principal Financial Group Inc. to provide one-on-one investment advice to employees. That was a big change, since under the old plan, workers had to sift through 11 different mutual-fund options on their own. Today Fields is back in a 401(k) big-time. He bumped up his contribution from 3% to 10% after one paycheck, and now he and his wife feel more comfortable about retirement. “This is going to be the nest egg we need,” says Fields.

ALON’s new automatic enrollment 401(k) is part of a sea change in employer attitudes toward retirement. Washing-

ton has allowed such plans since 1998, but only 14% of large companies embraced the trend as late as 2003.

Now a survey by benefits consultant Hewitt Associates suggests that figure could soar to 59% next year.

What accounts for the switch? New government regulations have helped, and consultants have been aggressively marketing the changes. In addition, as companies continue to drop traditional pension and retiree health coverage for new hires, they see automatic enrollment 401(k)s as a way to help employees make up the difference. Boosting enrollment by low-paid workers also helps employers get out from under federal rules that can limit contributions by higher-paid managers if 401(k)s aren’t used equitably throughout the company. Among the companies that have shifted to autopilot plans: J.C. Penney, IBM, and Motorola. “We’re seeing a lot more interest across the board,” says Lori Lucas, Hewitt’s director of participant research.

Automatic enrollment is just the first step. Companies also are automatically increasing worker contributions over their careers, defaulting workers into “lifestyle” mutual funds, and offering more investment advice for employees. Taken togeth-

GOLDEN YEARS
Fields ended up loving ALON’s automatic enrollment plan



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Social Issues Retirement

er, these changes could alter America's chronic personal savings shortfall. In fact, the new savings could end up being just as important as all the changes under discussion in the high-profile Social Security debate. The reason: Many U.S. workers underuse 401(k)s, a key way many save for retirement. Fully two-thirds of workers on company payrolls sign up for 401(k)s, but many start too late and don't save nearly enough for a comfortable retirement.

HAND-HOLDING

INDEED, THE MEDIAN balance of the country's 60 million 401(k)s is just \$50,000. And a staggering half of households headed by 50- to 59-year-olds have \$10,000 or less in their accounts. As a result, "there's a quarter to one-third of families that are not even in the game," says Brookings Institution economist William G. Gale. Automatic enrollment could change that. While most Americans want to save more, they are often overwhelmed by all the decisions they must make: how much to set aside, how to adjust their portfolios as they age, and so on. "Decisions create indifference and confusion, and when people aren't sure what to do, they don't save," says Stephen P. Utkus, principal at the Vanguard Center for Retirement Research.

The new opt-out systems take much of the decision-making off employees' shoulders. Under ALON's old 401(k), only about 40% of the company's workforce signed up, says Eric Nystrom, ALON's manager of benefits and payroll. Now 80% are participating in the retirement plan, he says. Studies show that is typical of automatic enrollment, with overall participation for new workers jumping from 49% to 86%.

The biggest benefit may be getting employees to start saving early. Today it can take as long as 10 years for workers to get around to signing up for a 401(k), losing critical years of investment returns. Even when they join, many fail to set aside enough for their old age. To deal with that problem, some plans, such as Philips Electronics North America's, automatically boost worker contributions each year.

The new plans hold employees' hands on investment choices, too. In early versions, workers defaulted into overly conservative money funds. Now, employers

are beginning to steer them into so-called lifestyle funds, which may invest 90% of a 25-year-old's assets in equities but automatically reduce stock holdings to 50% by retirement.

Some companies, like ALON, provide workers with online help or hands-on investment advice from a financial planner. A few other corporations are rolling out yet another version: managed accounts, in which workers make no investment choices at all. They simply turn over their money to a professional manager, which invests their assets as it would with a traditional pension plan. There's another benefit from such advice: Outsiders can encourage workers

As Employers Embrace Automatic 401(k) Signup...

Share of U.S. companies with automatic 401(k) enrollment

1999	2001	2003	2005
7%	14%	14%	59%*

*Estimate

Data: Hewitt Associates

...Savings Likely Will Soar
401(k) participation rates for newly eligible employees

	ALL	WOMEN	HISPANICS	LOW INCOME*
With automatic enrollment**	86%	86%	75%	80%
Without	49	35	19	13

*Earning less than \$20,000 a year

**Earning more than \$20,000 a year

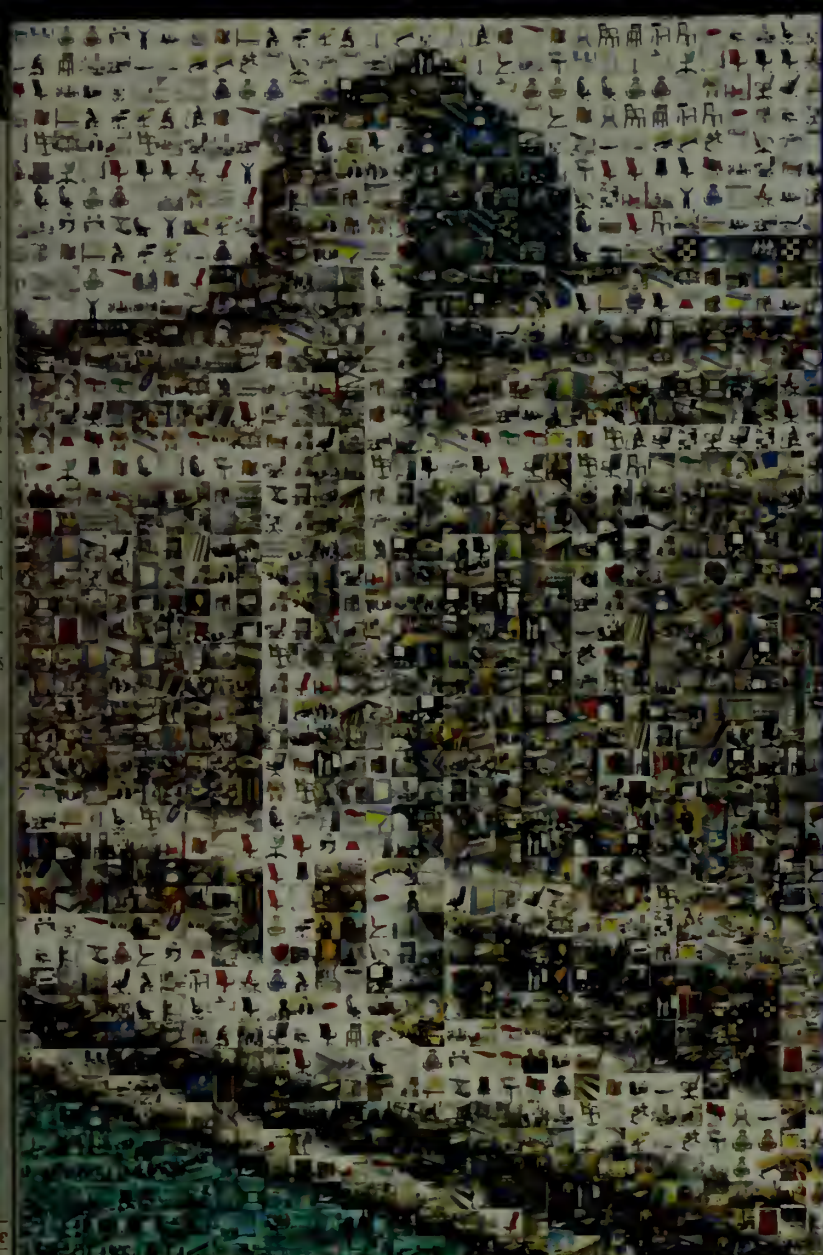
Data: Brigitte Madrian, Wharton School; Dennis Shea, UnitedHealth Group

to lighten up on company stock, something corporate managers are loath to suggest. At J.C. Penney Corp., for example, Financial Engines Inc. recommends that most employees trim their company stock exposure to 20% or less.

All this help comes at a price to workers, however. While many outside advisers provide management or advice for annual fees of 0.2% to 0.4%, others charge as much as 1.5%. Still, autopilot 401(k)s look like the future of corporate-based retirement savings. Many low-wage employees still will depend heavily on Social Security. But for middle-class Americans, saving for old age is becoming more and more automatic. ■

—By Howard Gleckman in Washington

BusinessWeek online For more on the savings debate, go to www.businessweek.com/extras



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Fat Times for A French Woman

The skinny on how diet author Mireille Guiliano is milking her newfound fame



COMMONSENSE
CHIC Guiliano's approach to diet is down to earth

MIREILLE GUILIANO, with the modesty that intimates a certain amount of success in life, persists in calling her best-selling memoir her "little book." *French Women Don't Get Fat*—officially, her guide to the secret of eating for pleasure, unofficially, her musings on how to enjoy life—has sold some 450,000 copies in North America since it was published in December, is available in 22 languages, and will even come out in French this fall. It has led to invitations to speak at London School of Business & Finance and appear on *Oprah*. It has turned the 59-year-old Guiliano, who runs champagne and wine company Clicquot Inc. in Manhattan, into an arbiter of the good life.

In this age of self-promotion, that sort of cachet rarely remains unexploited. Guiliano is no exception: She has used her celebrity to help sell Veuve Clicquot champagne (naturally) and her favorite yogurt maker, too. "My friends say everything I touch turns to gold. I'll say I've been very lucky," Guiliano says. However inadvertent her recent success, Guiliano is an experienced enough marketer to know how to take advantage of it. She has become a cottage industry of her own.

SPILLING SECRETS

GUILIANO HAS WRITTEN an epicurean's memoir. She tells of growing up in the French countryside, lingering over meals, drinking in the rules of gracious living. But she forgot them all during a disastrous year in high school when she lived in suburban Boston as an exchange student and gained 20 pounds on a diet of brownies and chocolate chip cookies. When she returned home, she slowly lost the weight under the guidance of her family doctor who retaught her the secrets of French women: moderation, balance, and pleasure when it comes to food. Guiliano says she has maintained her weight since then (she is 112 lb. and stands 5 ft., 3 in.). After attending university in Paris, falling in love with an American, moving to New York, and working first as a U.N. translator and then in advertising and public relations, in 1984 she was asked to help start a company, Clicquot Inc., to import the venerable French champagne to the U.S.

Guiliano has been an effective representative of Veuve Clicquot: by all accounts, charming, smart, and indefatigably social. Her first job at the company was as a (actually, the) salesperson, and it is her distinctly French voice that has been heard in the company's radio advertise-

ments ever since. The chefs, the distributors, the retailers, they all know Guiliano from the early days when she would regularly visit them. She still sends cards and bottles of La Grande Dame on their birthdays; she gave a draft of her book to their wives (hers is a business dominated by men). And although Clicquot was purchased by what became French luxury group LVMH Moët Hennessy Louis Vuitton in 1986 and recently became part of a new billion-dollar company, Moët Hennessy USA, that combines all of LVMH's wine and spirits brands in America, Guiliano has so far been able to do as she sees fit with little interference from Paris. In two decades, Veuve Clicquot has increased its share of the U.S. market from nearly nothing to about 23%.

But her little book may have done more to introduce Clicquot to those outside the privileged class than anything she has attempted before. As Guiliano says: "Those first two months of publicity, it's like 10 years' worth of publicity combined.... I was on *60 Minutes Australia*, with a bottle on the table. Do you know how much that would have cost? And with wine and champagne, you don't get on the CBS morning show here anyway [which she did appear on, as well as ABC and NBC]. And not only showing the bottles, but mentioning the brand. This is priceless. I should ask for a huge commission. Just kidding."

CHAMPAGNE TASTE

WHEN INTEREST FIRST began gathering for *French Women Don't Get Fat*, Guiliano imagined a brief book tour with perhaps a few champagne tastings. The president of Moët Hennessy, Christophe Navarre, saw something more: "He said: 'It will be great for Clicquot. Tell us what you need.'" What started out as a series of small events has turned into this year's marketing strategy at Clicquot. Guiliano is working with restaurants around the country (Aqua in San Francisco, Fountain at Four Seasons in Philadelphia, Carmen

The Restaurant in Coral Gables) to create dinners based on the family recipes included in her book. "It's a whole new initiative that we can do as much or as little as we want," she says. "And every time we do one, there's coverage from TV, newspapers, magazines."

The free publicity doesn't end there. At

in," says Deb Flynn, the company's marketing manager. Cuisipro isn't even promoting the connection. "We're letting the book do the PR for us," says Flynn.

The illustrator of *French Women Don't Get Fat*, Nick Hanzlik, is taking the opposite approach. Hanzlik now features the book on his Web site and says that

of the online orders at his R. Nichols stationery store in February (about 15% were from people who had read about him on Guiliano's own Web site). "That's my only marketing plan," Hanzlik says. "That and get on *Oprah*."

As for Guiliano, she says she doesn't think about her celebrity but is "amazed by the evolution of the book from best-seller to cultural phenomenon." And, no doubt, she has turned herself into a brand. In the language of the experts, she is the model European: elegant, accessible, more disciplined than, say, British chef and bon vivant Nigella Lawson, and more relaxed than, yes, the very Yankee Martha Stewart. The only risk for Guiliano is coming to be regarded as the next Dr. Atkins, says Juliette Cottineau, the executive director of consumer branding at Interbrand Corp.: "People are tired of diet gurus. She has become multidimensional to last."

Which sounds about right to Guiliano. She has

already rejected the idea of hosting a cooking show. Then there are the proposals to write a "lifestyle" book, get involved in some other television project, and develop a documentary film: Those she is considering. She says she won't make any decisions until the end of the year. What if her appeal has diminished by then? "I've never been ambitious.... If I was, I would have left Clicquot after the first five years," Guiliano likes to say, with a modesty that suggests she believes she hasn't yet received her last offer. ■

—By Susan Berfield in New York

BIO

Mireille Guiliano

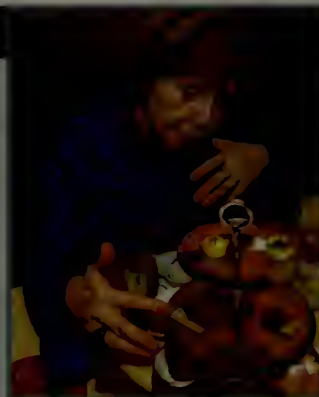
The making of an epicure—and a cottage industry:

BORN Apr. 14, 1946, Moyeuvre, France.

EDUCATION Undergraduate degree in French and English literature from the Sorbonne. Master's degree in English and German from the Institut Supérieur d'Interprétariat et de Traduction in Paris.

POSITION President and CEO of champagne company Clicquot Inc., which is owned by luxury group LVMH; author of the best-selling *French Women Don't Get Fat*.

BACK STORY Colleagues asked how she stays so slim when she eats 300 restaurant meals a year, drinks a glass of champagne daily, and never seems to deprive



herself. The book is her answer.

HOW TO EAT LIKE A FRENCHWOMAN Fool yourself. Enjoy small portions of several dishes at each meal. And never take more than three bites of dessert.

HER INDULGENCE Dark chocolate.

MANAGEMENT THEORY "If people have a good private life, they can do good work. If you have a lousy life, if you're not happy or are overweight, how can you have the energy to perform?"

FAMILY Married to Edward Guiliano, president of New York Institute of Technology; they maintain apartments in New York and Paris.



Sherry-Lehmann Wine & Spirits in Manhattan, for example, Michael Aaron, the chairman and a longtime friend of Guiliano, decided to help promote her book. He displays a copy with a poster, "A Must Read for Men and Women of Any Size," and a photo of the two of them at La Tour d'Argent restaurant in Paris. So far he has sold 600 books. And, he says, his sales of Veuve Clicquot increased 20%, to 125 cases, in March; sales for the other champagnes he carries didn't budge.

Veuve Clicquot is not the only business that is benefiting from Guiliano's newfound prominence. At Cuisipro, which distributes a \$42 Donvier yogurt maker she mentions in the book, the machines are "going out as fast as they're coming

BusinessWeek online For an interview with Mireille Guiliano and a review of her book, go to www.businessweek.com/extras



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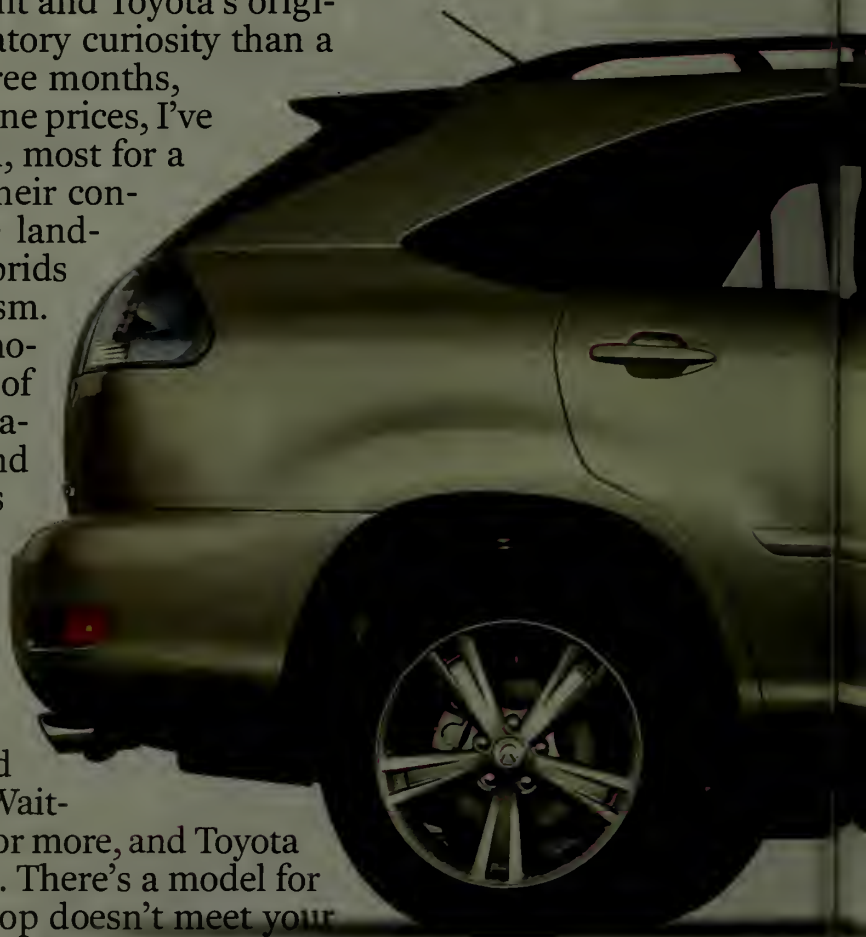
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Are You Ready For a Hybrid?

First, pick a car that matches the kind of driving you do—city or highway. Here are the scouting reports on six eco-friendly vehicles. **BY LARRY ARMSTRONG**

I'VE BEEN SHOPPING FOR SOMETHING to replace my aging Toyota, and I've come to this conclusion: My next car will be a hybrid. I've driven them all, starting in 1999 with Honda's quirky Insight and Toyota's original Prius, each more of a laboratory curiosity than a practical vehicle. In the past three months, with an eye on ever-loftier gasoline prices, I've driven all the mainstream models again, most for a week at a time and back to back with their conventionally powered counterparts. The landscape has really changed. ¶ Today's hybrids are no longer sops to environmentalism. They represent the biggest shift in automotive technology since the development of the gasoline engine. True, the first-generation hybrids were underpowered—and ugly. But the new wave, led by pioneers Toyota and Honda, is vastly improved. By marrying an electric motor with a conventional power train, hybrids save money at the pump, reduce consumption of foreign oil, cut tailpipe emissions, and maybe even give the car's performance an extra kick. ¶ Now the hybrid is firmly in the automotive mainstream. Waiting lists for some models are six months or more, and Toyota and Honda are selling all they can make. There's a model for just about anyone. And if the current crop doesn't meet your



» FINALLY, HERE'S A hybrid for high rollers—those who like to be socially responsible but aren't willing to give up the creature comforts of a luxury ride. It's the 2006 Lexus RX 400h, the first hybrid from a premium brand.

At first glance it looks identical to the RX 330, the

grand—more than \$11,000 above the base RX 330 with all-wheel drive. More than half of that is for equipment you would pay extra for on the RX 330, such as leather upholstery, moon roof, roof rack, and high-intensity headlights that swivel as you turn, along with a GPS

LEXUS RX 400h

best-selling entry-level luxury SUV from Lexus. A closer look, though, reveals a different grille, round fog lights, and a new bumper design that draws in more air to cool the hybrid system better. Taillights use LEDs instead of bulbs. The only indication on the exterior that this is a hybrid vehicle is the "h" in the name.

And check out the sticker: This car starts at nearly 50

navigation system.

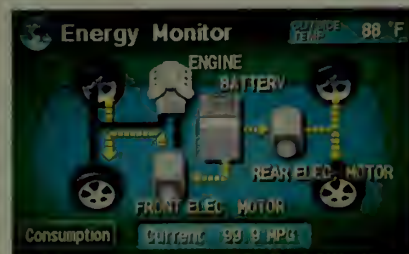
Get inside, and it feels like the usual opulent Lexus—with one key difference. Designers chose to go with brushed metal instead of wood trim, probably to reflect the high-tech nature of the car. Big mistake.

In the instrument cluster there's a little schematic under the speedometer to show the distribution of power between the gas and electric engines,

EYES RIGHT A digital screen in the center of the dashboard shows power flow

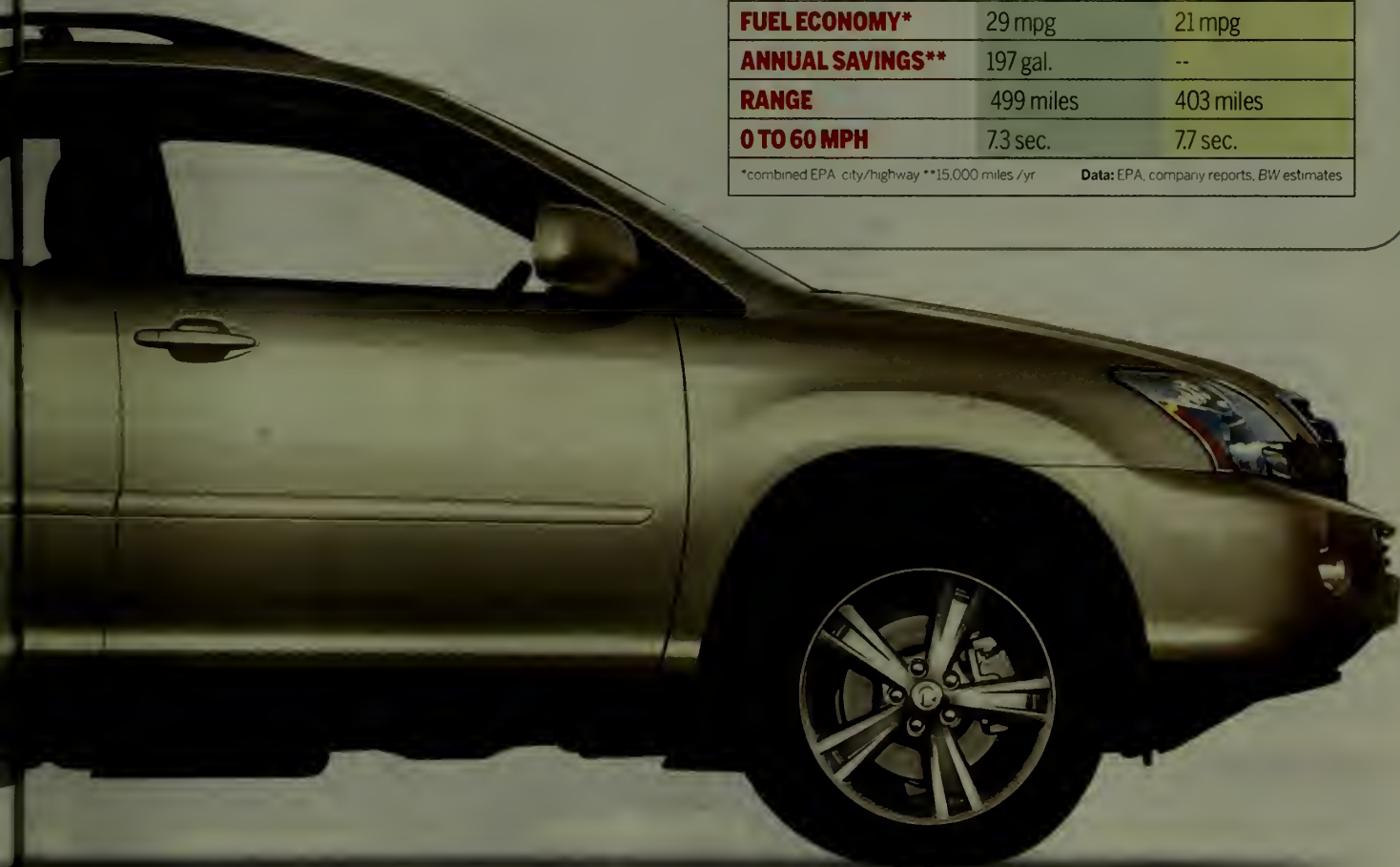
and the tachometer has been replaced by a gauge that shows power in kilowatts.

Because this is an all-wheel-drive car, the front and rear wheels have separate electric motors. They're mated to the same V-6 engine that's in the RX 330, and you can really feel the difference when all systems are go. Lexus says 0-to-60 times are a half-second faster than the 330s, but auto magazines have clocked them as low as 6.9 seconds. That's almost as speedy as the Mercedes-Benz ML500 SUV, which has a big, greedy V-8.



Luxury-car buyers are accustomed to the supreme quiet of a cabin that's well insulated from wind and road noise. But hybrids often make strange sounds, so when you test-drive the Lexus, be sure you don't hear any noises you can't live with. I was vaguely uncomfortable with a dull whine when the car was decelerating to a stop. What's acceptable in a \$20,000 Toyota Prius may not be in a \$50,000 Lexus.

	LEXUS RX 400h	LEXUS RX 330 AWD
BASE PRICE	\$49,185	\$38,075
FUEL ECONOMY*	29 mpg	21 mpg
ANNUAL SAVINGS**	197 gal.	--
RANGE	499 miles	403 miles
0 TO 60 MPH	7.3 sec.	7.7 sec.
*combined EPA city/highway **15,000 miles/yr Data: EPA, company reports, BW estimates		



needs—or your fancy—just wait. Next year will see a half-dozen new hybrids from such nameplates as Chevrolet, Lexus, Mazda, Nissan, Saturn, and Toyota (table). Toyota, in fact, says it will eventually offer a hybrid version of virtually every car it sells. All told, 200,000 Americans will buy a hybrid car this year, up from 90,000 in 2004. Who's buying? Mainly baby boomers who are a little more educated and wealthier than those who buy the regular models.

A CAR FOR EVERY DRIVER

WANT A GAS-thrifty econo-box with four, maybe five, seats and gussied up with all the amenities? The plain-look-

MORE HYBRIDS ON THE WAY

2005

Mercury Mariner SUV

Toyota Highlander SUV

2006

Chevrolet Malibu

Lexus GS 450h

Mazda Tribute SUV

Nissan Altima

Saturn Vue SUV

Toyota Camry

2007

Chevrolet Tahoe/GMC Yukon SUV

Ford Fusion/Mercury Milan

Lexus LS 430h

Toyota Sienna minivan

performance. It's arriving in dealers' showrooms just about now. (Unless you're one of the more than 13,000 folks who has put down a deposit, you're unlikely to get one much before the end of the year.)

You'll never persuade your dealer to lend you one long enough to get a feel for the car, so I've put together cheat sheets that catalog the differences. Price and fuel economy figures in the tables are for hybrids with an automatic transmission. For the comparison car, I selected the model in the line that comes closest in standard features and priced it

ing Honda Civic Hybrid and the showier Toyota Prius cost about 20 grand each. For a family sedan, there's the Honda Accord Hybrid. If you like the above-it-all seating of a sport-utility, you can consider a hybrid version of the Ford Escape compact SUV, introduced last fall, or the seven-passenger Toyota Highlander, due in June. If price is no object (but social status is), the Lexus RX 400h beats your neighbor's RX 330 in fuel economy, emissions, and

TOYOTA PRIUS



HONDA CIVIC

THE CIVIC HYBRID WAS the first mainstream hybrid on the market when it was introduced in 2003—and it's the premium car in Honda's popular Civic family. It gets its fuel savings by using a stingy, 1.3-liter gasoline engine that's helped along, when necessary, by the electric motor. That kicks in for hard acceleration to join freeway traffic or go up long grades.

The hybrid's spoilers, front and rear, are different than those of other Civics, and it has lightweight alloy

wheels. Inside, look for a better grade of fabric on the seats and automatic climate control, neither of which is available on the rest of the line. As with the Accord

Hybrid (page 124), you'll have to give up the moon roof to get the hybrid.

Perhaps the best feature of the hybrid Civic is that it feels heavier and more substantial, and quieter, on the open road, more like a bigger car than the subcompact it really is.

	HONDA Civic Hybrid	HONDA Civic EX Sedan
BASE PRICE	\$21,415	\$18,275
FUEL ECONOMY*	48 mpg	34 mpg
ANNUAL SAVINGS**	127 gal.	--
RANGE	634 miles	449 miles
0 TO 60 MPH	12 sec.	10 sec.

*combined EPA city/highway **15,000 miles/yr Data: EPA, company reports, B.V. estimate



BusinessWeek online

For more information on these and other hybrids, as well as a slide show, go to businessweek.com/extras

» THE TOYOTA PRIUS IS the head-turner among hybrids. It gets its sleek, futuristic look from its aerodynamic design, and that carries over into the inside. There's no instrument panel behind the wheel: The gauges are digital and compressed into a slim, horizontal slice just beneath the windshield. The shift lever takes a bit of getting used to. It's really a joystick that jumps back to the home position when you release it. There's no key, either. To start the car, you press the Power button. The Ready light comes on, but the gasoline engine doesn't kick in until you reach 10 or 15 mph. That means

pedestrians in parking lots can't hear you coming.

It's surprisingly roomy, with more rear legroom than the Camry. The Prius is peppy enough, and the car's video game-like display encourages you to drive with a light foot, rewarding you with a green leaf symbol for every 50 watt-hours of electricity you regenerate during braking and coasting.

Many owners say they don't get the advertised fuel economy, but that's true of most cars. For the record, I drove it 332 miles, including a round trip from Los Angeles to Palm Springs, and got a respectable 51.7 mpg.

	TOYOTA Prius	TOYOTA Corolla LE	TOYOTA Camry LE
BASE PRICE	\$21,515	\$16,230	\$20,515
FUEL ECONOMY*	55 mpg	34 mpg	28 mpg
ANNUAL SAVINGS**	168 gal. over Corolla	--	--
	263 gal. over Camry		
RANGE	654 miles	449 miles	518 miles
0 TO 60 MPH	10.0 sec.	9.0 sec.	9.7 sec.

*combined EPA city/highway **15,000 miles/yr

Data: EPA, company reports, BW estimates



DIGITAL GAUGES
Clean
behind
the wheel

» HERE'S A SNEAK PEEK AT the Toyota Highlander Hybrid coming in June. Think of it as a dressed-down version of the Lexus RX 400h, the luxury sport-ute Toyota introduced in April (page 119). The good news is that, unlike with the Lexus, which comes with every imaginable amenity already built-in and priced to match, you'll be able to skip options you don't want, such as a moon roof or full-time four-wheel drive.



TOYOTA HIGHLANDER

No matter how it's outfitted, you'll still pay \$7,000 more than for a Highlander without the hybrid power train. The hybrid system commands \$4,700 of the premium; the rest comes from standard equipment you have to pay extra for in conventionally powered Highlanders, such as alloy wheels and eight-way power controls on the driver's seat. Most important: standard side air bags and side curtains that

protect against head injuries in rollovers, which cost \$680 extra in the nonhybrid Highlander.

Outside the car, you can tell it's a hybrid by a new, chrome-trimmed grill, different headlights and taillights, and the Toyota's Hybrid Synergy Drive logo on the tailgate. The instrument panel uses Lexus-like electroluminescent displays. The usual tachometer is replaced by a gauge that

shows watt-hours instead of RPMs, and there's a display to show whether power is flowing to or from the batteries.

The hybrid Highlander is

faster than the V-6. If you're looking for V-8 kick in an SUV that sips gas more like a four-cylinder sedan, this hybrid may be for you.

	TOYOTA Highlander Hybrid 2WD	TOYOTA Highlander 2WD V-6
BASE PRICE	\$33,595	\$26,555
FUEL ECONOMY*	30 mpg	21 mpg
ANNUAL SAVINGS**	214 gal.	--
RANGE	516 miles	401 miles
0 TO 60 MPH	7.3 sec.	7.8 sec.

*combined EPA city/highway **15,000 miles/yr

Data: EPA, company reports, BW estimates

Personal Business Cars

without adding any optional equipment.

I didn't bother with a couple of hybrids. The Insight, Honda's two-seater and the first hybrid sold in the U.S., has been largely eclipsed by the hybrid Civic sedans. Only 583 Insights were sold last year. General Motors has a big pickup, the Chevy Silverado, that comes in a hybrid version. The fuel savings is scant—only a mile or two per gallon. The real attraction

is four 120-volt outlets that tap the electric generator to power your tools at a construction site or your TV at a campsite.

Hybrids cost more than their conventional counterparts because of the added electric motor and the batteries. That premium ranges from \$1,500 on the Silverado pickup to about \$4,500 on the Lexus and Highlander SUVs, and about \$2,500 to \$3,500 on the others. That's only the

beginning: The newfound popularity of hybrids has prompted carmakers to perch them at the top of the line, full loaded with "standard equipment" such as premium cloth or leather upholstery, third-row seats, or four-wheel drive. Want them or not, you'll still have to pay for them to get the hybrid.

If you're looking to make that up by saving a buck or two at the pump, the

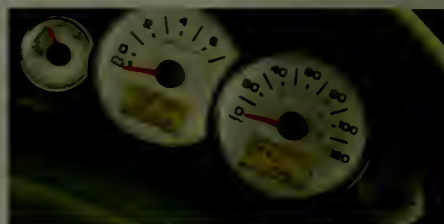
» THE FIRST "GREEN" sport-ute to make it to market is the hybrid version of Ford's Escape, the best-selling small SUV. It's a four-cylinder vehicle, but the electric motor boosts the performance to that of the Escape V-6. In fact, I found that because of the weight of the batteries, which are under the cargo floor, the hybrid version handles better than other Escapes.

With the exception of two-tone paint, not available on nonhybrid Escapes, the hybrid looks much the same. There's also a hybrid badge with Ford's road-and-leaf insignia behind the front wheels and on the tailgate, and the hybrid

has a small vent on the driver's side rear quarter-window to help keep the batteries cool. Inside, the instrument cluster includes a "green-zone" gauge that indicates when the car is running solely on battery power and another that shows whether the car is replenishing the battery pack.

An optional \$1,850 navigation system that's available only on the hybrid includes more displays of the hybrid energy system, such as an instantaneous fuel economy indicator and a diagram that shows the power flow from the gas engine and

electric motor and back to the batteries. That package also has a souped-up audio system. Other options: a 110-volt AC power outlet in the center console (\$180) for running small electrical appliances and side air bags and side curtains for crash protection (\$595). You can also get a four-wheel-



drive version of the Escape Hybrid for \$1,625 more.

Here's what's not available: a \$2,000 cash rebate, which Ford is offering on conventional Escapes through June.

FORD ESCAPE

	FORD Escape Hybrid	FORD Escape XLT
BASE PRICE	\$27,400	\$23,105
FUEL ECONOMY*	33 mpg	23 mpg
ANNUAL SAVINGS**	197 gal.	--
RANGE	495 miles	380 miles
0 TO 60 MPH	9.0 sec.	11.0 sec.

*combined EPA city/highway **15,000 miles/yr Data: EPA company reports. EVI estimates.

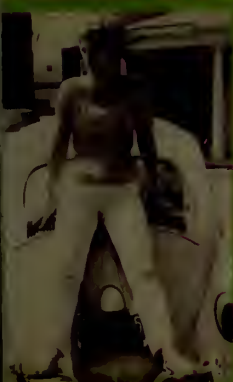


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YUPPIE
PROTESTER
DEMOCRAT
REPUBLICAN
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Personal Business Cars

economics have always been iffy, but soaring gas prices are altering that. Start with tax savings: For me, the federal one-time deduction of \$2,000 for clean-fuel cars translates to a combined \$623 savings on my 2004 federal and California income taxes. Some states, including Colorado, Connecticut, Maine, New York, and Utah offer more generous tax credits, or they exempt the car from sales taxes.

Next, figure out how much you'll save in fuel based on how much you drive and what price you pay for gas. (You can go to mixedpower.com, a Web site for hybrid owners, to find an online calculator for this.) With regular gasoline now averaging more than \$2.60 a gallon in California, I would have to drive a Honda Accord for about six years to make up the premium I paid for the hybrid. Higher gasoline

prices will shorten that payback period.

You can maximize your savings by picking the hybrid that best matches the kind of driving you do. All hybrids shut down the gasoline engine when you're stopped, either in traffic or at a stoplight. But the Ford and Toyota systems can use the electric motor to drive the car, so they can go without the gas engine at low speeds. The result? Unlike most cars, the

» The 2005 Accord Hybrid made its debut in December as the top-of-the-line version of Honda's popular family sedan. You'll have to look closely to see the differences between it and the similarly equipped gasoline-powered Accord EX V-6, which sells for about \$3,300 less. The hybrid has different alloy wheels, a small spoiler on the rear deck, and the "Hybrid" badge on the back of the trunk. Honda also made two changes to help offset the weight of the hybrid

separate climate controls for driver and passenger, and a sound system with a CD-changer and satellite radio. The only option is a \$2,000 navigation system.

There are subtle differences in the instrument cluster that hint at the hybrid under the hood, including lights that indicate the V-6 gas engine is in its fuel-saving mode or has shut down, which happens only when the car is idling. There's also a gauge that shows whether the

	HONDA Accord Hybrid	HONDA Accord EX V-6
BASE PRICE	\$30,655	\$27,365
FUEL ECONOMY*	33 mpg	24 mpg
ANNUAL SAVINGS**	170 gal.	--
RANGE	564 miles	410 miles
0 TO 60 MPH	7.5 sec.	8.0 sec.
*combined EPA city/highway **15,000 miles/yr		Data: EPA, company reports

reduce the trunk space by about 20%, to 11.2 cu. ft.

So what does your \$3,300 premium buy you, besides fuel economy? The electric motor adds horsepower, which gets you from 0 to 60 mph in 7.5 seconds, a half-second quicker than with the conventional V-6. You'll also notice a few quirks that will let you know you're driving a hybrid. As you decelerate, the brakes get noticeably softer in the fraction of a second before the car stops. The gas engine turns off

while you're stopped. When you take your foot off the brake to get going again, you can feel a slight stutter as the engine turns on.

The hybrid Accord gets a good part of its fuel economy—it's thriftier even than Honda's four-cylinder Accord—by shutting down three of its six cylinders when the car is cruising (a few conventional cars do this, too). You can't hear it or feel it; you only know because an "ECO" light on the dash flashes on.

HONDA ACCORD

system: The hood is aluminum, which you'll never notice, and you can't get a moon roof with this car.

Inside, just like the Accord EX, it's almost a luxury car, with leather power seats,

batteries are charging or running the electric motor. The batteries are behind the rear seats, so you can't fold down the seats to get access to the trunk the way you can in other Accords. The batteries also



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best fuel economy is in city driving instead. That's just the ticket if you spend much of your life in stop-and-go traffic. Honda hybrids, on the other hand, use their electric motor to give a little extra boost to the gas engine, when you need it for accelerating, for example. That lets you get by with a smaller engine so you'll save gas on longer trips at cruising speeds.

It's hard to put a price on some of the perks of driving a hybrid. What would you pay for unlimited access to car-pool lanes, as in Virginia, or not having to feed parking meters, as in San Jose, Calif.? Another intangible: Better fuel economy also means you can go farther between trips to the gas station.

The downside? The batteries that power the electric motor cost thousands. And

they'll eventually have to be replaced. Trouble is, hybrids are too new to say when. But right now, they're warranties, along with the rest of the hybrid system, to go eight years or 100,000 miles.

That's not much of a risk. If you're shopping for a car, or even if you're not, maybe it's time to take a hybrid out for spin. You'll find yourself driving along the cutting edge of the car business. ■

Itching to Ditch the Slow Lane

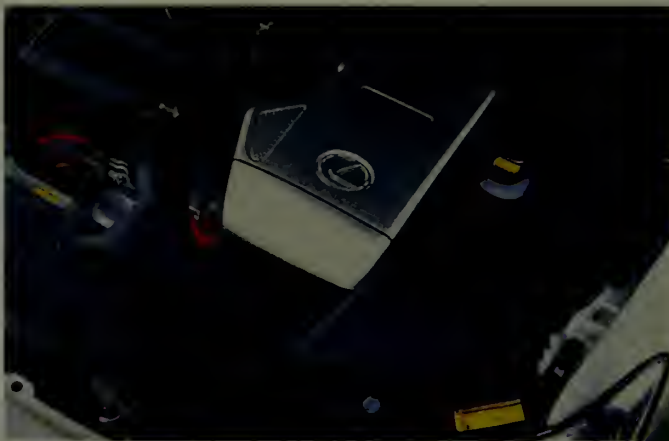
Better batteries will turbocharge sales. **BY DAVID WELCH AND CHESTER DAWSON**

ANDREW ABRANCHES loves pulling into the parking lot at Northrup Grumman's space technology center in Redondo Beach, Calif., each morning in his Honda Civic hybrid. Among the plethora of Beemers and Benzes, the 35-year-old engineer says his car makes a statement that he is thrifter and more tech-savvy than his colleagues. "I could have gotten a small car that gets close in mileage" to the hybrid, he says. But "I like the technology more than anything else."

Toyota, Honda, and other hybrid manufacturers have won over buyers, such as Abranches, who love gadgets, buy green, or just want to stick it to OPEC. But the technology will have to deliver more—and for less money—if hybrids are going to penetrate deeper into the market than just 0.5% of the 17 million U.S. car-buying consumers every year. To boost that share, carmakers must overcome daunting technological hurdles—most of all, making hybrids' battery systems smaller, less costly, and more powerful. That would cut the nearly \$4,000 price premium hybrids command and boost mileage. It could also deliver a big payoff in driver

comfort. "Improving driving performance and pleasure is the next frontier for hybrids," says Takehisa Yaegashi, Toyota's senior manager for hybrid power train development.

Battery technology has already made great strides from the early days. Today's nickel metal hydride battery systems cost about \$2,000 to \$3,000 a car—less than half the price of the first Prius power packs back in 1997. And they weigh half



LEXUS HYBRID
For Toyota, "pleasure is the next frontier"

the 170 pounds of the batteries in that first generation.

Even so, better batteries may be the biggest barrier in reducing the cost of hybrids. Honda estimates that the battery accounts for about 60% of the \$3,300 extra cost of its Accord Hybrid. One company insider says if the hybrid price premium could be halved, the technology could grab two-thirds of auto sales. For now, battery raw materials are expensive and, despite improvements, batteries still must be big to store a lot of energy.

Rising car sales spread those high costs

over more units, but battery manufacturing capacity is still constrained. Only three companies—Panasonic, Sanyo Electric, and Cobasys, a division of Energy Conversion Devices in Rochester Hills, Mich.—make them for hybrid cars. All are adding production, but Toyota still had to delay the launch of its Lexus RX 400h hybrid SUV because of tight supplies. Plus, the mobile-phone business could boost competition for nickel metal hydride batteries if their use in signal towers takes off. J.D. Power & Associates cited the continued high costs of hybrid batteries when the firm recently capped at 3% its estimate of the market share it expects hybrids to attain by 2010.

WORLDWIDE RACE

ENGINEERS FROM TOKYO to Detroit are working on solutions, including lithium ion batteries, which have greater power density and cheaper raw materials. But for now, lithium batteries are too expensive to make—and they can't handle the shocks of a moving vehicle. Says John German, American Honda Motor's manager for environmental and energy analysis: "Lithium ion is 10 years [away from volume production]."

As batteries improve, they will do more than save space. They could allow cars to drive in ghostly quiet electric mode longer. With faster computer processors, future hybrids should manage a smoother transition between electric power and gas. The goal: a switchover to gas that is barely noticeable to the driver. When hybrids are given cheaper, more powerful electrical guts, their popularity will really take off. ■

EDITED BY TODDI GUTNER

TIME OFF

HAVE A SPRING FLING WITH ART

WHETHER YOU'RE A follower of French culture, American modernism, or Japanese pop culture, you'll find something to your liking at New York's museums this spring.

More than three decades after Coco Chanel's death, knockoffs of her bouclé

suits still fill department store racks. To see the originals, visit the Costume Institute at the **Metropolitan Museum of Art** from May 5 to Aug. 7 (metmuseum.org).

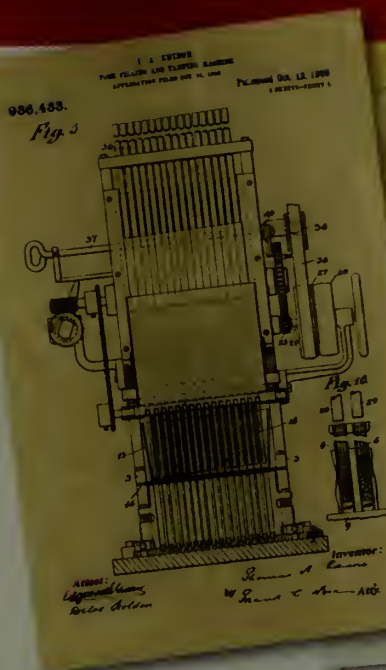
The exhibit also features designs of Karl Lagerfeld, who began revitalizing the label in 1983.

Jean-Michel Basquiat was born in Brooklyn, so it's fitting that the **Brooklyn Museum** has organized a retrospective of his works (brooklyn-museum.org/basquiat). The exhibition will run through June 5 before moving to Los Angeles, then Houston. Basquiat got his start spraying graffiti. A protégé of Andy Warhol, he was a supernova of SoHo's 1980s art scene before dying from a drug overdose at age 27.

Sure, Hello Kitty,

dzilla, and the crew of the Spaceship
mato are on display, but a **Japan
society of New York** exhibit is not just for
s (japansociety.org). “Little Boy:
e Arts of Japan’s Exploding
oculture,” through July 24, explores
dark origins of Japan’s *otaku* or
toon geek subculture.

—Monica Gagnier, Chester Dawson



temperatures of 100°
baths are to be kept at 70° Fahr
hereafter -
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St. Louis, Mo.
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Law Litcher of Danville,
Va. should call on you, please
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possibly can about recovering
remains of a step-sister,
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I am Dear Sir
Yours most obedt. servt.
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COLLECTIBLES

Cashing In on Abe

COLLECTING OLD LETTERS and documents is not only fun but can also be a good investment, according to a new analysis by Abraham Wyner, assistant professor of statistics at the **Wharton School**. He figures the annualized return from 1949 through 2002, the study period, was 10.3% for best-quality items, comparable to stock returns, and 9.8% for simple autographs. In the study's final decade, top-quality items—important documents signed by major historical figures—outperformed stocks, generating an 11.7% annual return, two points more than the **Standard & Poor's** 500-stock index.

Wyner's study, commissioned by **Ardmore** (Pa.) dealer Steven Raab (raab-collection.com), shows it's smart to go for the best material. The top Abraham Lincoln item in Raab's inventory, a letter discussing the Civil War blockade of the South, costs \$900,000, vs. \$3,000 or less for a good Jimmy Carter piece. Auction house and dealer fees of about 20% to 50% will reduce real-life returns and make quick profits near-impossible. Wyner advises holding onto historical documents for a minimum of 10 years.

—Thane Peterson

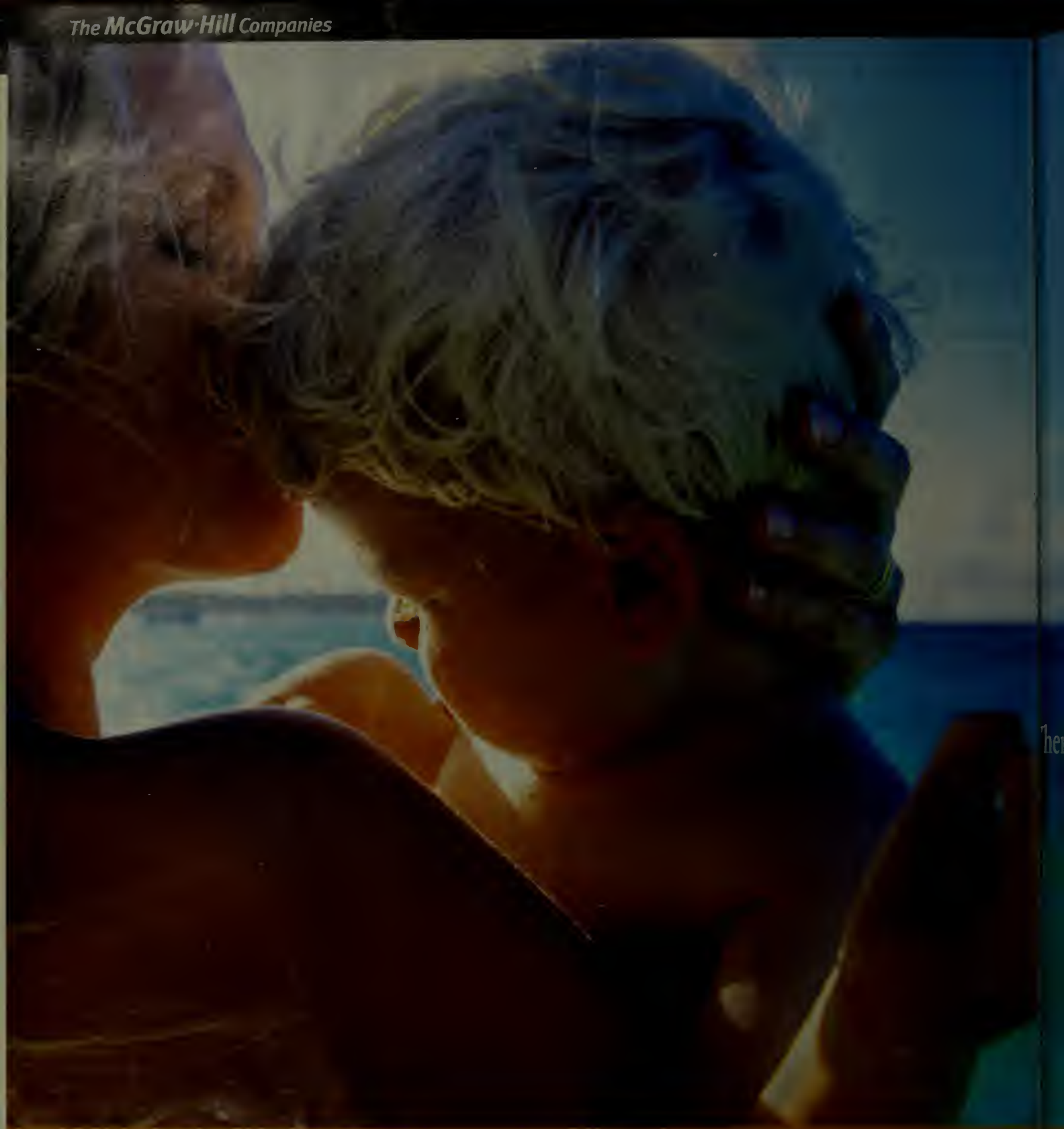
—Thane Peterson

WINE

HERE'S ONE WAY TO avoid losing track of all those bottles in your wine cellar. **General Electric's \$25,000 Monogram Walk-in Wine Vault** has an electronic inventory management system that lets you locate bottles by country, type, and vintage using a touch-screen monitor. Users can also program the vault for the optimal time to open a bottle. The almost 8-ft.-by-9-ft. freestanding unit, designed for ideal temperature and humidity, stores nearly 1,100 bottles and must be professionally installed in your home (ge.com).



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A romantic couple is shown in profile, kissing on a beach. The scene is bathed in the warm, golden light of a sunset or sunrise, with the ocean visible in the background. The couple's hair is blowing in the breeze, adding a sense of movement and intimacy to the image.

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BY ROBERT BARKER

Dividend Income Without the Hassle

In the two years since Washington slashed tax rates on most corporate dividends, investors have come both to relish and loathe the term "qualified dividends." Relish, since instead of a tax of 35% or more, the top rate on qualified dividends is 15%. Loathe, because just what

makes a dividend qualified is, in Uncle Sam's reflexively odious way, far more complicated than it need be.

It's not just that dividends from some foreign companies, most partnerships, and much of the payout from real estate investment trusts don't qualify for the tax break. Suppose you owned Merck, a 4.6% yielder that hit plenty of bumps last year. If you held a steady position in it, no problem. But suppose you simply traded in and out a bit. Then you may have fallen into a 60-day holding-period trap for the time around dividend payments. Some dividends would qualify for the lower rate, some would not, and the onus would be on you to sort it out. (Rules: Internal Revenue Service Publication 550 or irs.gov/businesses/small/article/0,,id=122523,00.html.)

Ugh. This is part of why two exchange-traded funds, or ETFs, that track indexes of high-yielding stocks are taking in money fast. Barclays Global Investors introduced its iShares Dow Jones Select Dividend Index Fund in November, 2003. It now boasts more than \$6.1 billion in assets. Last December it got a direct rival in PowerShares High Yield Equity Dividend Achievers Portfolio, which already has drawn assets of nearly \$500 million. Either is a reasonable alternative to running your own dividend-stock portfolio or to a traditional mutual fund focusing on

income, such as Washington Mutual Investors Fund (yield: 2%). They pay more than most traditional funds, notes Dan Culloton, a Morningstar analyst, and they're cheaper (table).

Yet they are not without risks, including greater-than-average exposure to particular industries, such as utilities. Seven of the PowerShares fund's top 10 current holdings are utilities. With 100 companies rather than PowerShares' 50, the iShares fund is less concentrated in any particular sector. But it still owes plenty of its yield to financial stocks, such as Bank of America, which are vulnerable to rising interest rates. Another danger: the chance investors will be less charmed by dividend-payers tomorrow than they were yesterday. In 2004 the iShares ETF returned 17.9%, seven percentage points more than the Standard & Poor's 500-stock index. This year its total return is a negative 2.3%, a bit worse than the index. The PowerShares fund is off quite a bit more (chart).

The rudest shock could come at tax time. It turns out that not all of the dividends from these funds necessarily will pass Uncle Sam's scrutiny as qualified. When the funds periodically trade shares to get back in line with their indexes they may run afoul of holding-period rules. This is why the iShares fund's 2004 distributions of \$1.91 per share included 28¢ of nonqualified income—a fact surprising even to John Prestbo, editor of Dow Jones Indexes, creator of the index the iShares fund tracks.

How much nonqualified dividends would hurt depends naturally, on how much money you have in one of these funds and your tax situation. An investor in the 35% income-tax bracket who had put \$100,000

into the iShares fund at the start of 2004 would have seen a pretax dividend yield of 3.6% and an aftertax yield of 2.9%. Had all of the dividends qualified for the 15% tax rate, the aftertax yield would have been a bit over 3%.

So these funds aren't perfect. That said, for income-seeking investors with little time to manage their own portfolios, they look to me like a neat solution. ■

E-mail: rb@businessweek.com

FACE-OFF: DIVIDEND-PAYING ETFs

Fund (SYMBOL)	iShares Dow Jones Select Dividend Index (DVI)	PowerShares' High Yield Equity Dividend Achievers (PEY)
Recent Price	\$59.97	\$14.49
Dividend Yield	3.2%	3.7%
Expense Ratio	0.4%	0.5%
Stocks in Fund	100	50
Top Holdings	Altria Group, FPL Group, Kinder Morgan	Consolidated Edison, Progress Energy, Nicor
Web Site/Phone	ishares.com 800 474-2737	powershares.com 800 983-0903

Data: Company reports, Morningstar, Standard & Poor's

DIVIDEND PAYERS' SLUMP

TOTAL RETURN, YEAR TO DATE*	-2.1%	STANDARD & POOR'S 500 STOCK INDEX
	-2.3%	ISHARES DOW JONES SELECT DIVIDEND INDEX FUND
	-5.1%	POWERSHARES HIGH YIELD EQUITY DIVIDEND ACHIEVERS PORTFOLIO

Data: Morningstar, Standard & Poor's

*THROUGH APR. 11

e l e v a t e technology

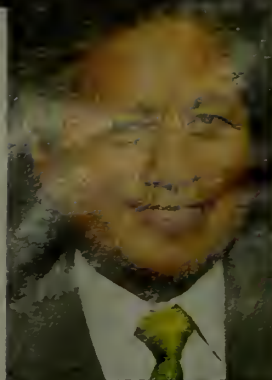
Cleaner fuels. Advanced fuels. Liquefied natural gas. Converting gas fuels into liquids. 3-D seismic technology for the discovery of new fuels. Ultra-deepwater drilling and production technology to access once unreachable sources of fuels. Shall we go on? When it comes to energy technologies, our answer to that question is, "yes we will." Because at ConocoPhillips, discovering and innovating new technologies is just another way we elevate.



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BY GENE G. MARCIAL

DRUGMAKERS RELY ON GENETIC TECHNOLOGY FROM AFFYMETRIX

STOCK IN UNIFORM SUPPLIER CINTAS IS RUMPLED—AND CHEAP.

CLEAR CHANNEL'S RADIO STATIONS ARE SOLID MONEymAKERS.

Affymetrix: A Lab Boost

WITH ITS GENETIC-PROBING technology, Affymetrix (AFFX) is sure to be a key player in making drugs safer and in reducing their development cost. So argue some pros who are buying shares, which have climbed sharply—from 25 in August to 44 on Apr. 13. Affymetrix' proprietary GeneChip for DNA analysis is "now the No. 1 system for studying complex genetic data used in researching the link between genes and diseases," says Marion Schultheis, managing director at J. & W. Seligman, which has bought shares. GeneChips are dime-size glass wafers that contain massive genetic data harvested by scientists. Medical researchers use them to monitor genetic mutations that correlate with specific diseases. The GeneChip, primarily sold to pharma and biotech companies, researchers, and clinical labs, is becoming a vital tool in conducting clinical trials—and

Schultheis figures this will become a big market for Affymetrix. GeneChip can reduce the risk of adverse reactions to drugs by checking the recipient's DNA against the drug's profile. "In this post-Vioxx period, drugmakers are under more pressure to come up with less toxic drugs fast—and Affymetrix helps in such a process," says Schultheis, who sees the stock at 59 in a year. John Sullivan of securities firm Leerink Swann, who rates Affymetrix "outperform," says some 60 drug trials since 2003 have used GeneChips to help analyze clinical results. Sullivan expects operating margins to widen from 16.5% in 2004 to 30% in 2007. He estimates earnings for 2005 at 87¢ a share on sales of \$404 million, for 2006 at \$1.27 on \$494 million, and for 2007 at \$1.70 on \$589.5 million.



SCHULTHEIS Buying

When you want to express your devotion to The Dow, nothing says it like Diamonds (DIA). Exchange traded funds (E They're tax efficient, and have low management fees, too.* Like stocks, Diamonds can be traded all day long, and of course you can buy them on the Dow Jones website at www.DowDiamonds.com. Ticker symbol Amex:DIA. The 30 blue-chip companies of The Dow in every share.

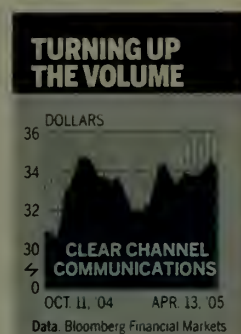
An investor should consider investment objectives, risks, charges and expenses of the investment company carefully before investing. Please read the prospectus carefully before investing. *Usual brokerage commission applies. Dow Jones Exchange LLC pursuant to a License Agreement with Dow Jones. Diamonds are not sponsored, endorsed, sold or promoted by Dow Jones and Dow Jones makes no representation or warranty regarding the Diamonds Trust. ALPS Distributors, Inc., a registered broker-dealer, is distributor for the Diamonds Trust, a unit investment trust.

Can Cintas Get Its Starch Back?

THE HUMDRUM business of renting out uniforms—to airlines, hotels, and supermarkets—is a big moneymaker for Cintas (CTAS). The largest U.S. uniform provider had revenues of \$2.8 billion and profits of \$272 million in 2004. More than 5 million workers wear its uniforms. But the stock has sagged, from 46 a share on Dec. 2 to 41 on Apr. 13, in part because of weaker-than-expected hiring. However, Bruce Thompson of investment firm William H. Miller, which owns stock and has done banking for Cintas, says shares have hit bottom. “The stock is the lowest in five years,” he notes. The price has yet to reflect the “momentum in fundamentals that has been building for two years,” he says. The continuing recovery should boost employment, and Cintas’ new products, such as fire safety gear and bathroom cleaners, are selling well. Leone Young of Smith Barney, which does banking for Cintas, rates it a buy and puts earnings at \$1.73 in 2005, \$2.03 in 2006, and \$2.28 in 2007. Her price target: 55.



radio stations, has seen its stock bounce from 29 in October to 34.15 on Apr. 13. Behind the comeback are “steps such as limiting commercials—and diversifying programming,” says Sarat Sethi of investment boutique Douglas C. Lane. Management has focused on boosting its core business and generating strong cash flow. Clear Channel’s other businesses—outdoor advertising and live entertainment production—are also expected to drive growth. Investors don’t yet recognize radio’s growing strength and are overly concerned about competition from satellite radio and music players, he says. In two to three years, he figures, Clear Channel will generate \$2.60 a share in free cash flow, and he sees the stock hitting 44 in 12 to 18 months. Maurice McKenzie of investment bank Friedman Billings Ramsey forecasts earnings of \$1.47 a share in 2005 and \$1.63 in 2006, up from \$1.41 in 2004. He believes Clear Channel will remain “the dominant operator” in domestic radio, outdoor, and live entertainment. McKenzie rates the stock only “market perform,” however, because, he thinks, it isn’t yet clear how advertisers will react to Clear Channel’s new policy of cutting commercial airtime—and raising the ad rates. ■



Clear Signal at Clear Channel

SATELLITE RADIO AND MP3 players are drowning out some investors’ interest in radio’s long-term potential. Still, Clear Channel Communications (CCU), a media company that draws 41% of revenues from its more than 1,000

BusinessWeek online

Gene Marcial’s Inside Wall Street is posted at businessweek.com/today.htm at 5 p.m. EST on the magazine’s publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor their firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.

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STOCKS



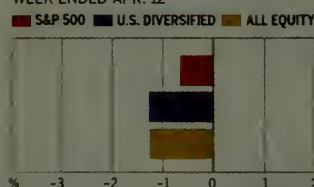
COMMENTARY

Nervous investors zigzagged in and out of equities. Mild language in the latest minutes released by the Fed sent stocks up on Apr. 12, but that gain was gone the next day—and then some. Weighing on the Dow was Caterpillar, whose investors sold shares in search of the next hot sector. Tech stocks got battered, as the NASDAQ fell 1.6% on Apr. 13. Meanwhile, oil prices sank from their high.

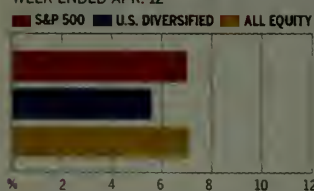
Data: Bloomberg Financial Markets, Reuters

MUTUAL FUNDS

4-WEEK TOTAL RETURN



52-WEEK TOTAL RETURN



Data: Standard & Poor's

U.S. MARKETS

	APR. 13	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1173.8	-0.9	-3.1	3.9
Dow Jones Industrials	10,403.9	-0.8	-3.5	0.2
NASDAQ Composite	1974.4	-1.2	-9.2	-2.7
S&P MidCap 400	647.7	-1.8	-2.4	7.7
S&P SmallCap 600	315.2	-2.0	-4.1	10.3
DJ Wilshire 5000	11,553.9	-1.0	-3.3	4.6

SECTORS

	APR. 13	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
BusinessWeek 50*	690.3	-2.4	-2.0	8.0
BW Info Tech 100**	345.8	-1.1	-7.4	-1.3
S&P/BARRA Growth	566.9	-0.7	-2.6	1.4
S&P/BARRA Value	602.5	-1.1	-3.7	6.5
S&P Energy	328.5	-4.7	13.8	37.3
S&P Financials	380.9	-0.5	-7.4	-2.6
S&P REIT	134.5	1.8	-6.9	21.3
S&P Transportation	216.8	-3.2	-10.2	13.9
S&P Utilities	151.3	1.2	6.9	27.7
GSTI Internet	154.2	-2.6	-13.5	-2.1
PSE Technology	714.5	-1.1	-8.3	-2.1

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS

	APR. 13	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	1394.0	0.6	-0.2	
London (FT-SE 100)	4960.8	0.3	3.0	
Paris (CAC 40)	4116.9	0.2	7.7	
Frankfurt (DAX)	4405.7	0.6	3.5	
Tokyo (NIKKEI 225)	11,637.5	-1.6	1.3	
Hong Kong (Hang Seng)	13,799.6	1.8	-3.0	
Toronto (S&P/TSX Composite)	9492.1	-1.9	2.7	
Mexico City (IPC)	12,424.4	2.1	-3.8	

FUNDAMENTALS

	APR. 12	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	2.01%	2.02%	1.5%
S&P 500 P/E Ratio (Trailing 12 mos.)	19.9	19.8	22.2
S&P 500 P/E Ratio (Next 12 mos.)*	15.5	15.4	17.1
First Call Earnings Surprise*	9.93%	11.89%	6.4%

TECHNICAL INDICATORS

	APR. 12	WEEK AGO	REAR
S&P 500 200-day average	1153.2	1152.0	Posit
Stocks above 200-day average	65.0%	64.0%	Neut
Options: Put/call ratio	0.77	0.81	Posit
Insiders: Vickers NYSE Sell/buy ratio	4.59	4.77	Negat

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Health-Care Facilities	13.3	Fertilizers & Ag. Chems.	69.5
Commercial Printing	8.9	Oil & Gas Refining	68.6
Food Wholesalers	6.3	Oil & Gas Drilling	50.7
Internet Software	6.2	Constr. & Engineering	49.3
Housewares & Specils.	6.1	Oil & Gas Exploration	47.0

WORST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Home Entertainment	-26.7	IT Consulting	-5.1
Motorcycle Manufacturers	-19.0	Insurance Brokers	-3.1
Automobiles	-18.3	Automobiles	-3.1
Multi-line Insurers	-17.3	Electric Mfg. Svcs.	-2.1
Steel	-14.3	Semiconductor Equip.	-2.1

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Health	1.4	Natural Resources	36.1
Utilities	0.9	Latin America	31.4
Domestic Hybrid	-0.6	Real Estate	27.7
Communications	-0.6	Utilities	26.9
LAGGARDS		LAGGARDS	
Precious Metals	-9.4	Technology	-9.6
Financial	-2.8	Japan	-4.8
Japan	-2.6	Precious Metals	-3.7
Diversified Pacific/Asia	-2.3	Small-cap Growth	0.1

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
ProFunds USh. Dow 30 Inv.	4.7	ProFunds Oil & Gas Inv.	65.2
Rydex Ivse. Dyn. Dow 30 H	4.7	BlackRock Gl. Res. Inv. A	52.7
ProFds. USh. Sm. Cap Inv.	4.5	AIM European. Sm. Co. A	49.2
ProFds. USh. Mid Cap Inv.	4.4	U.S. Gbl. Invs. Gl. Rscs.	46.6
LAGGARDS		LAGGARDS	
American Heritage Growth	-14.3	Ameritor Investment	-51.6
U.S. Global Invs. Gold	-13.1	Apex Mid Cap Growth	-42.9
ProFunds Precs. Mtls. Inv.	-13.1	ProFunds Semicdr. Inv.	-33.8
U.S. Gl. Invs. Prec. Mnls.	-12.2	Reynolds	-32.7

INTEREST RATES

KEY RATES

	APR. 13	WEEK AGO	YEAR AGO
Money Market Funds	2.31%	2.29%	0.2%
90-Day Treasury Bills	2.77	2.76	0.95
2-Year Treasury Notes	3.65	3.69	2.08
10-Year Treasury Notes	4.36	4.43	4.37
30-Year Treasury Bonds	4.68	4.74	5.17
30-Year Fixed Mortgage †	5.86	5.93	5.88

†BancQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
General Obligations	3.82%	4.56
Taxable Equivalent	5.46	6.51
Insured Revenue Bonds	3.98	4.64
Taxable Equivalent	5.69	6.63

THE WEEK AHEAD

PRODUCER PRICE INDEX

Tuesday, Apr. 19, 8:30 a.m. EDT » March producer prices most likely increased by 0.4% for a second straight month. That's the median forecast from economists polled by Action Economics. Minus food and energy, the core price index probably rose 0.2%, after edging up 0.1% during February.

RESIDENTIAL CONSTRUCTION

Tuesday, Apr. 19, 8:30 a.m. EDT » Housing starts should have

eased to an annual rate of 2.15 million in March. February starts jumped to a rate of 2.2 million.

CONSUMER PRICE INDEX

Wednesday, Apr. 20, 8:30 a.m. EDT » March consumer prices for goods and services are forecast to have risen 0.4%, after increasing 0.4% in February. Excluding food and energy items, prices presumably posted a smaller 0.2% gain, after climbing 0.3% in the previous month.

BEIGE BOOK Wednesday, Apr. 20, 2 p.m. EDT »

The Federal Reserve will release its report on regional economic activity before its May 3 monetary policy meeting. Economists will be looking for anecdotal news of price pressures.

LEADING INDICATORS Thursday, Apr. 21, 10 a.m. EDT »

The Conference Board's March index of leading economic indicators probably fell by 0.2% after inching up 0.1% for February.

The BusinessWeek production index edged down to 238.9 for the week ended Apr. 2 but remained 10.4% above the year-ago level. Before calculation of the four-week moving average, the index fell to 238.3.

BusinessWeek online

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/magazine/extra.h

CONTROLLING BUSINESS INSURANCE COSTS

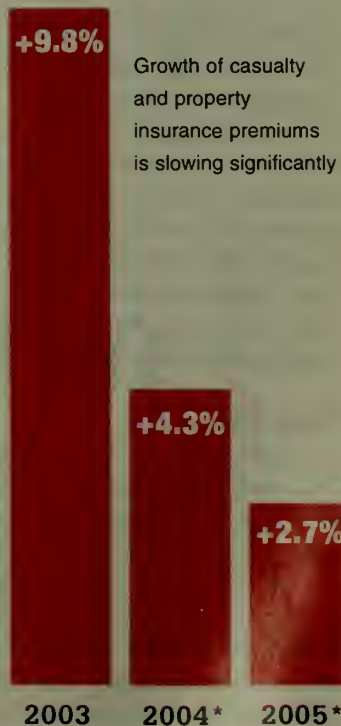
Insurers, Business,
and Government Work
Together To Keep Business
Insurance Costs Down

The Insurance Information Institute's (III) February 2005 industry forecast brought American businesses some much-needed good news on the insurance front. According to the III, casualty and property insurance premiums are expected to rise just 2.7% in 2005, down from an estimated 4.3% increase in 2004 and a 9.8% increase in 2003. Indeed, notes III Chief Economist Robert Hartwig, "premium growth in 2004 came in well below analysts' expectations from a year ago."

These slowdowns in premium growth have not come at the expense of insurers' financial well-being, but rather are the result of "increased economic growth and higher demand associated with the current economic recovery." Indeed, forecasts for the industry's combined ratio, or the ratio of losses and expenses to premiums, continues to represent a "vast improvement" over those of 2001 and 2002. What's more, had the incidence of natural catastrophes in 2004 been in line with historical norms, the industry's combined ratio for the year would have been at its most favorable level in more than three decades.

Still, despite these improvements, insurers and their business customers continue to face some serious cost concerns. In this section, we profile two of the most prominent—health-insurance costs and the aforementioned cost of natural catastrophes—and highlight the steps that some of the industry's leading insurers are taking to help keep these costs under control. *(continued on the next page)*

Growth Slowdown



Source: III
*Estimate

Keeping Health Insurance Costs Under Control

More than a decade after the Federal government attempted to reform the nation's health care system, U.S. health costs are rising as rapidly as ever. According to the National Coalition on Health Care, a Washington, D.C., based research group, health insurance premiums for an average U.S. family by 2006 will exceed \$14,500—and premium costs will have increased by more than \$5,000 in just three years.

Because American businesses pay the majority of these costs, the rise in health premiums significantly reduces job growth, holds down employee wages, and

family of products has intensified Aetna's focus on engaging consumers in health care decision-making and getting the most value from their plan," explains Robin Downey, Aetna's head of product development.

The flagship resource used to help members maximize their benefits is Aetna Navigator™, the company's member-only self-service web site. Aetna Navigator is

>>> THE GOAL

Keep health costs within reasonable bounds while ensuring the highest feasible quality of care, through the elimination of inefficiencies, administrative overhead, and unnecessary treatments.

designed to serve as a "one-stop shop" for members seeking access to a wide range of health-related tools and information. According to the company, Aetna Navigator works to give Aetna members "the information and guidance they need to navigate the health care system and to make the most informed decisions along the way."

Included in Aetna Navigator are Health A to Z and Aetna IntelliHealth, two of the industry's most sophisticated, consumer-oriented sources for health information; a variety of self-assessment tools that allow consumers to gauge their personal health risk and encourage them to adopt healthier behaviors and lifestyles; and a preventive care schedule for essential health screenings, like mammograms, eye exams, and immunizations, based on national guidelines for age and gender.

"The introduction of the Aetna HealthFund family of products has intensified Aetna's focus on engaging consumers in health care decision-making and getting the most value from their plan."

—ROBIN DOWNEY, AETNA

forces up product and service prices, making American companies less competitive here and abroad. Clearly, something must be done.

Not waiting for the government to act, a number of health insurance companies themselves have taken far-sighted steps to rein in health insurance costs for employers and employees alike. Their goal: to keep health costs within reasonable bounds while ensuring the highest feasible quality of care, by encouraging health-plan members to act as informed, empowered health-care consumers.

Leading the Way

Hartford, Conn.-based Aetna, one of the nation's leading health insurers, is leading the way in developing practical products, tools and information for helping businesses and their employees themselves to bring health-care costs under control.

Central to Aetna's efforts is its Aetna HealthFund® consumer-directed product suite that provides businesses and consumers with vital health-care decision-making information. "The introduction of the Aetna HealthFund

Controlling Costs

To further boost the utility of its decision-making suite, Aetna last August introduced a powerful new component called "Estimate the Cost of Care," an integrated collection of interactive tools that allow members to project the cost of various treatment options before they even visit their doctor.

The Estimate the Cost of Care toolset enables Aetna members to view health cost information in several key categories, and provides a clear comparison of estimated average in- and out-of-network costs for such products and services as prescription drugs, dental procedures, standard medical procedures, doctor's office visits, medical tests, and specific diseases and conditions.

The toolset thereby reinforces Aetna's existing emphasis on helping its members get the most value from their health benefits. Notes Aetna's Downey: "The Estimate the Cost of Care suite of tools illustrates Aetna's commitment to continuously enhance the tools and information that help consumers anticipate and take charge of their health care expenses." ●

We
want
you to
know

The Cost of Care

Now there's a better way to predict health care costs.

When people understand what things really cost, they can make smarter choices. That's the idea behind Aetna's Estimate the Cost of Care, an online tool that helps your employees plan for and manage health care expenses. They'll get estimated cost information, based on their zip code, for 200 medical and dental procedures, office visits, and medical tests, as well as over 7,000 different prescription drugs. This information can also help them predict the annual cost of treatment for a wide range of conditions depending on the level of severity. To see how our information can help your employees make better informed health care decisions, call your broker, Aetna representative, or visit us today at aetna.com.

We want you to knowSM



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Protecting Against Catastrophic Risk

The year 2004 will be remembered for many reasons, but in the insurance world, one fact will stand out: 2004 was the most expensive year on record for property insurance claims worldwide.

According to one estimate, some 330 natural and man-made catastrophes occurred around the world last year, in which more than 300,000 people lost their lives (280,000 of these were killed or missing as a result of the Asian tsunami). Property losses arising from these events totaled \$123 billion, of which \$49 billion were covered by property insurance.

Despite the catastrophic impact of the Asian tsunami, the

and global coverage, reinsurers tend to be financially strong companies, with a highly rated capital base. In fact, the majority of reinsurers are rated at least single 'A' by Standard and Poor's, and only a few reinsurance bankruptcies have occurred, usually among very small and inadequately capitalized firms.

Still, reinsurers are constantly innovating to protect against the kind of catastrophic risks that the industry had to bear in 2004. Central to this mission are ongoing efforts to prepare ahead of time for such catastrophes—an effort that involves analyzing potential changes in the risk landscape and developing contingency plans and policies for dealing with them.

Because they possess more loss data than any other institution, insurers are in the best position to carry out this "early warning" function. However, insurers historically have made less use of this capability than many experts believe they should have. To overcome this deficiency, many of the world's leading reinsurers have built up teams of experts to study all relevant aspects of risk, from questions of risk perception to the development of new technologies.

>>> THE GOAL

Provide insurers with all necessary risk-related information that can be jointly analyzed, evaluated, and employed in designing new insurance instruments and coverage protocols, and to advise government and other leaders about policy-related changes that may be needed to minimize future risks.

The goal: to provide insurers with all necessary risk-related information that can be jointly analyzed, evaluated, and employed in designing new insurance instruments and coverage protocols, and to advise government and other leaders about policy-related changes that may be needed to minimize future risks.

Absolute security, of course, will never be achievable, since the future by its nature is unknown and thereby inherently risky. But manageable risks can be achieved. To reach that point, leading reinsurers believe, industry and public leaders must work together to identify and influence risks early on, and ensure that they have made adequate provision for such events should a loss occur. ●

Reinsurance is insurance for insurers. Insurers typically buy reinsurance for risks that they cannot or do not wish to fully retain themselves.

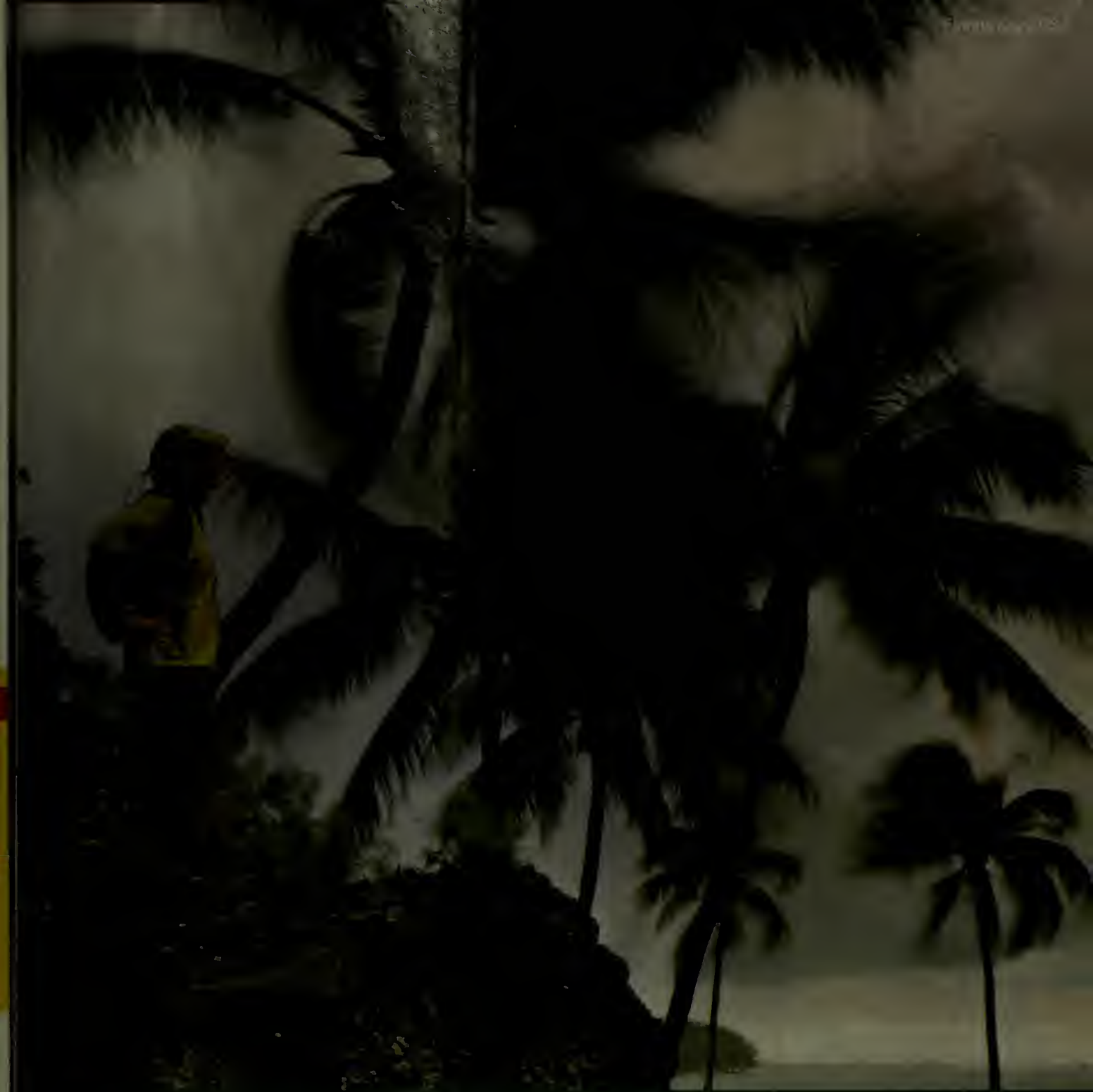
majority of these insured losses were due to an unusually high number of windstorms—15 hurricanes in the United States and ten typhoons in Japan—and the increased concentration of insured property in highly exposed coastal regions. Because natural events like weather and earthquakes (and even many man-made destructive acts) are generally beyond control—and because population growth and insured property concentration are likely to continue—insurance companies must look to other means to mitigate and insure against catastrophic risk. Reinsurance itself is one of the most effective tools in this regard.

Insuring the Insurers

Reinsurance is insurance for insurers. Insurers typically buy reinsurance for risks that they cannot or do not wish to fully retain themselves. Reinsurers help the insurance industry to provide protection for a wide range of risks, including the largest and most complex risks that the insurance system covers. Insurers also benefit from the capital relief that reinsurance provides and from reinsurers' product development skills and risk expertise. Reinsurance is thus an indispensable part of the insurance system that makes both consumer and business insurance more secure and less expensive.

Because of their combination of expertise, capital base,

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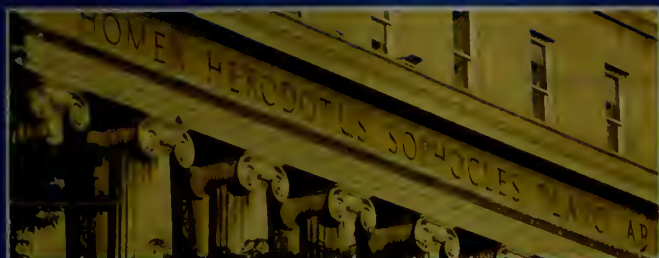
BusinessWeek (ISSN 0007-7135) Issue number 3930, published weekly, except for one week in January and one in August, by The McGraw-Hill Companies, Inc. Executive, Editorial, Circulation, and Advertising Offices: 1221 Avenue of the Americas, New York, N.Y. 10020. Periodicals postage paid at New York, N.Y., and at additional mailing offices. Canada Post Publication Mail Agreement Number 40012501. Return undeliverable Canadian addresses to: DPGM Ltd., 4960-2 Walker Road, Windsor, ON N9A 6J3. Email: bwcustmerservice@mcgraw-hill.com
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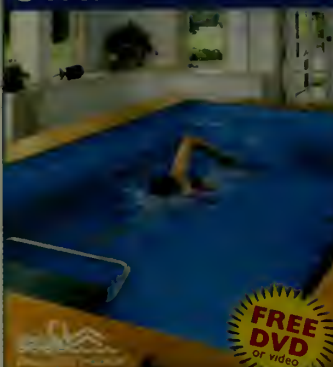
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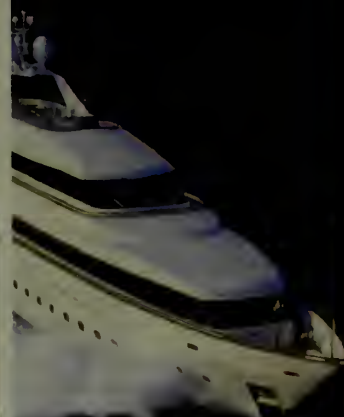
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Due Process— Even for Bigwigs

NO ONE EVER ACCUSED New York Attorney General Eliot Spitzer of mincing words, and his recent rhetoric slamming the behavior of American International Group Inc. and its former Chairman Maurice R. “Hank” Greenberg is no exception. “We call that fraud,” Spitzer bluntly told ABC-TV’s George Stephanopoulos last weekend, referring to some of AIG’s transactions. “It is deceptive. It is wrong. It is illegal.”

So much for innocent until proven guilty. No charges have been filed against AIG. Spitzer had yet even to interrogate Greenberg when he publicly slammed the company’s actions before millions of TV viewers. Instead, Spitzer has been busy serving up red meat to a scandal-weary public—and pressing any corporate director who has ever heard of Sarbanes-Oxley to think about settling. That may be a good way to bring a swift conclusion to the AIG mess, but it’s bad for American traditions such as due process and the rule of law.

It doesn’t take a Harvard-educated lawyer (which Spitzer is) to recognize that winning a battle in the court of public opinion is easier than winning in a court of law. And Spitzer has had an amazing run using the threat of public vilification. Another weapon is New York’s expansive Martin Act, giving him extraordinarily broad subpoena powers in financial fraud investigations, which usually unearth tons of documents that

can be used in civil suits. These tools have induced miscreants to settle charges and pay hefty fines. Think Merrill Lynch, Salomon Smith Barney, and the mutual-fund industry.

We wouldn’t find this expedient path to justice so worrying except that Spitzer seems more and more convinced that the end always justifies the means. Indeed, in a speech in Dublin last week to the Law Society of Ireland, he seemed actually to question the right of AIG executives to refuse to answer regulators’ questions. As any lawyer knows, simply invoking the Fifth Amendment protection against self-incrimination is not an admission of guilt. It’s an option used by many defendants for many reasons—and a tenet of the of the American legal system.

To be sure, there are some mighty scary things coming out of the AIG investigation: tales of executive compensation slush funds, questionable accounting, and what may well turn out to be a deliberate attempt to smooth earnings. But the Founding Fathers never intended for any AG to be policeman, prosecutor, judge, and jury, all in one. Although at times inconvenient, this separation of powers was an amazingly wise decision and one that separates the U.S. from the Evil Empires of old and the Axis of Evil of today. Indeed, how can we press developing states like China or Iran to embrace equitable legal systems and the rule of law if we treat the due process rights of our own citizens in such a cavalier manner?

The bully pulpit and the Martin Act authority that Spitzer has so deftly used in the past can easily become dangerous weapons. So he would be wise to remember that hunters who carry loaded guns should always take care to walk, not run.

that. One concerns 401(k) plans (page 108). Half of U.S. households headed by people aged 50 to 59 with 401(k)s have \$10,000 or less in their retirement accounts. Increasingly, employers are automatically enrolling employees in 401(k)s, while still allowing them to opt out if they insist. Some are going further, steering employees into “lifestyle” funds whose investment mix becomes more conservative as retirement nears. These are steps in the right direction.

Another opportunity for reform is credit-card borrowing (page 98). Many people max out their cards and then cross over into the nightmarish world of “negative amortization,” in which late fees and interest get added on to debts that continue to grow. The question is: What intervention is effective yet not heavy-handed? The Comptroller of the Currency is pushing banks to require bigger minimum monthly payments. But these could pinch many families severely. A less invasive solution might be to impose a national limit on credit-card interest rates, making it easier for cardholders to dig out of debt.

The U.S. should never become a “nanny state.” But smartly designed interventions can make just about everyone better off.

A Dollop Of Paternalism

AMERICANS CHERISH their freedom of choice. They’re properly suspicious of rulemakers who claim to have their best interests at heart. At the same time, lots of people choose badly—dropping out of school, blowing their savings, falling into addiction. Those who stumble can end up as wards of the state, at great expense. So steering them in the right direction is worthwhile. The goal should be to achieve the greatest effect with the lightest hand, using what some behavioral economists have called “minimally invasive paternalism.”

Two articles in this issue highlight opportunities for just

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